Petition

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IN THE

Supreme Court of the United States

OCTOBER TERM 1981

In re HOLIDAY AIRLINES CORPORATION, a California corporation (formerly known as Holiday Recreational Resources and Holiday Resources Corporation),

Bankrupt.

Curtis B. Danning, Trustee in Bankruptcy of HOLIDAY AIRLINES CORPORATION, a California corporation (formerly known as Holiday Recreational Resources and Holiday Resources Corporation),

Petitioner,

vs.

WORLD AIRWAYS, INC.,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTIONS PRESENTED

1. If the holder of a consensual lien on an aircraft attempts to perfect its lien by taking possession of the aircraft and does not record its lien with the Federal Aviation Administration, is that lien enforceable against a subsequent bona fide purchaser without notice of the aircraft?

2. Did Congress, by enacting the recordation provisions of the Federal Aviation Act, 49 U.S.C. Sections 1403-1406, intend to preempt the field of recordation of interests in aircraft and provide a single uniform method of perfecting interests in aircraft?

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Curtis B. Danning, Trustee in Bankruptcy of HOLIDAY AIRLINES CORPORATION, a California corporation (formerly known as Holiday Recreational Resources and Holiday Resources Corporation),

Petitioner,

vs.

WORLD AIRWAYS, INC.,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Curtis B. Danning, Trustee in Bankruptcy of Holiday Airlines Corporation, hereby petitions the Court for a writ of certiorari to issue to the United States Court of Appeals for the Ninth Circuit to review its judgment entered on June 8, 1981.

OPINIONS BELOW

The Memorandum Opinion of the Bankruptcy Judge filed on June 10, 1977, was not officially reported, but was unofficially reported in 13 C.B.C. 361 (1977). A copy of that Memorandum Opinion is attached as Appendix A.

The Memorandum of Decision of the United States District Court for the Central District of California filed on October 2, 1978 and entered on October 3, 1978 is unreported. A copy of that Memorandum of Decision is attached as Appendix B.

The Opinion of the United States Court of Appeals for the Ninth Circuit, filed on June 8, 1981, is reported at 647 F. 2d 977 (9th Cir. 1981). A copy of that Opinion is attached as Appendix C.

The Order of the United States Court of Appeals for the Ninth Circuit denying a petition for rehearing, filed on July 21, 1981, is unreported. A copy of that Order is attached as Appendix D.

JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1). The judgment of the United States Court of Appeals for the Ninth Circuit is contained in an Opinion entered on June 8, 1981 [App. C]. An Order denying a petition for rehearing was filed on July 21, 1981 [App. D].

STATUTES INVOLVED

The following statutory provisions are involved in this case:

49 U.S.C. Section 1301(20)

"As used in this chapter, unless the context otherwise requires—

* * *

(20) 'Conveyance' means a bill of sale, contract of conditional sale, mortgage, assignment of mortgage, or other instrument affecting title to, or interest in, property."

49 U.S.C. Section 1403(a)(1)

> "The Secretary of Transportation shall establish and maintain a system for the recording of each and all of the following:
>
> (1) Any conveyance which affects the title to, or any interest in, any civil aircraft of the United States."

49 U.S.C. Section 1403(c)

> "No conveyance or instrument the recording of which is provided for by subsection (a) of this section shall be valid . . . unless such conveyance or other instrument is filed for recordation in the office of the Secretary of Transportation . . . ."

STATEMENT OF THE CASE

Holiday Airlines Corporation ("Holiday") operated a commercial intrastate airline between Los Angeles and Lake Tahoe, California. Holiday's fleet included two Lockheed Electra aircraft identified as "aircraft 971" and "aircraft 974."

Aircraft 971 was owned by Petroleum Investment Services, Inc. ("Petroleum") and was leased by Petroleum to Holiday. The lease agreement required that Holiday at its own expense maintain the aircraft in good order and repair and perform such maintenance as necessary to comply with FAA Air Worthiness directives. The lease agreement further specifically provided:

> "THIRTEENTH—LESSEE shall have no right to consent to, allow, or permit any liens or encumbrances on said AIRCRAFT."

Aircraft 971 also was subject to a security interest in favor of Central Bank and Trust Company ("the Bank"). That security interest had been duly recorded with the Federal Aviation Administration pursuant to Section 503 of the Federal Aviation Act, 49 U.S.C. § 1403.

Aircraft 974 was owned by Holiday free and clear of liens.

World Airways, Inc. ("World") was an approved aircraft repair station in the business of performing aircraft service and maintenance. On October 7, 1974, Holiday and World entered into a Maintenance, Overhaul and Repair Agreement for the purpose of providing for the service of Holiday's aircraft. That agreement provided:

> "[World] shall have a lien upon customer's aircraft and components for the value of all services furnished, including, without limitation, reasonable compensation for storage incurred by [World] by reason of customer's failure to accept delivery of aircraft or other flight equipment."

On December 7, 1974, Holiday delivered aircraft 971 to World for servicing. The Aircraft remained in World's possession until January 24, 1975. During that period of time World supplied services that had a reasonable value of $70,165.05. World did not give written notice to Petroleum or the Bank prior to supplying these services, nor was written consent of either sought or obtained in connection with these services. World never attempted to record its claim of lien on aircraft 971 with the Federal Aviation Administration pursuant to 49 U.S.C. § 1403.

On January 24, 1975, all of Holiday's aircraft, including both 971 and 974, were in World's possession for servicing. To meet its schedule commitments, Holiday needed to obtain the release of at least some of its aircraft, but World would release none unless payment for services with respect to any aircraft released was made or adequate security to assure such payment was made. To solve this problem, it was agreed that World would surrender possession of aircraft 971 and Holiday would execute and deliver to World a chattel mortgage on aircraft 974 to secure the $70,165.05 owed with respect to aircraft 971. This was accomplished on January 24, 1975. However, possession of aircraft 971 was surrendered several hours before the chattel

mortgage on aircraft 974 was executed and delivered. This chattel mortgage was recorded pursuant to 49 U.S.C. § 1403 on January 28, 1975.

Aircraft 974 was sold immediately thereafter and World received payment on January 31, 1975, of the $70,165.05 due for servicing aircraft 971. The end for the purposes of this case came shortly thereafter. On February 13, 1975, Holiday filed a petition for an arrangement under Chapter XI of the Bankruptcy Act and subsequently was adjudicated bankrupt.

On July 16, 1975, petitioner commenced an action against World in the bankruptcy court. In that action petitioner contended that World had no valid perfected lien on aircraft 971 with the consequence that the chattel mortgage on aircraft 974 was given and the resulting payment was made in discharge of an antecedent debt. Specifically, petitioner urged that World's failure to record its lien on aircraft 971 pursuant to 49 U.S.C. § 1403 left it unperfected; that in any event World's lien was invalid, except to the extent of $250.00, under Cal.Code Civ. Proc. § 1208.62 because no notice was given to either Petroleum or the Bank by World before it commenced to service aircraft 971 and no written consent to do the work was obtained from either; that a consensual lien on an aircraft cannot be perfected by possession pursuant to Cal. Comm. Code § 9305; and that even if a consensual lien on an aircraft could be perfected by possession of the aircraft, the lien was extinguished because World surrendered possession of aircraft 971 to Holiday prior to the execution and delivery of the chattel mortgage on aircraft 974.

At trial, following petitioner's presentation of its case, World moved for judgment arguing that it had a valid possessory lien on aircraft 971 and that the subsequent execution and delivery of the chattel mortgage on aircraft 974 constituted a substitution of collateral, and not the transfer of property on account of an antecedent debt. The Bankruptcy Court agreed, granted World's motion, and on July 8, 1977 entered judgment for World.

Petitioner appealed to the United States District Court for the Central District of California. In a Memorandum of Decision entered on October 3, 1978, that Court found that because the "consensual" lien purportedly created by the Repair Agreement was merely an embodiment of the statutory lien created by Cal. Code Civ. Proc. § 1208.61, and because World had failed to comply with the notice requirements of Cal. Code Civ. Proc. § 1208.62, World's lien on aircraft 971 was limited to $250.00 and any payment in excess of that sum was a voidable preference. Alternatively, the district court held that to the extent World had an independent consensual lien on aircraft 971, that lien was invalid pursuant to 49 U.S.C. § 1403(c), inasmuch as it had not been recorded with the Federal Aviation Administration. The decision of the Bankruptcy Court thus was reversed.

World appealed to the United States Court of Appeals for the Ninth Circuit. In an Opinion filed on June 8, 1981, the Court of Appeals held that World had a valid consensual lien for the full amount of its debt, that the consensual lien was perfected by possession pursuant to Cal. Comm. Code § 9305, *that Congress did not intend to and had not preempted the field of recordation of interests in aircraft by enacting Section 503 of the Federal Aviation Act, 49 U.S.C. § 1403, and that World's lien was not invalid for failure to be recorded pursuant to 49 U.S.C. § 1403.* A petition for rehearing was denied on July 21, 1981.

REASONS FOR GRANTING THE WRIT

The decision of the Court of Appeals that Congress has not preempted the field of recordation of interests in aircraft and that a consensual lien on an aircraft may be perfected against a subsequent bona fide purchaser without notice in the absence of recordation of the lien with the Federal Aviation Administration is in direct conflict with decisions of other Courts of

Appeals [*Bank of Lexington v. Jack Adams Aircraft Sales, Inc.*, 570 F.2d 1220 (5th Cir. 1978); *State Securities Co. v. Aviation Enterprises, Inc.* 355 F.2d 225 (10th Cir. 1966)], is in direct conflict with decisions of district courts in circuits where the Court of Appeals has not faced the question [*Haynes v. General Electric Credit Corp.*, 432 F.Supp. 763 (W.D. Va. 1977); *Industrial Nat. Bank of Rhode Island v. Butler Aviation International, Inc.*, 370 F.Supp. 1012 (E.D.N.Y. 1974); *United States Aviation Underwriters, Inc. v. WTAE Flying Club*, 300 F.Supp. 341 (W.D. Pa. 1969); *Northern Illinois Corp. v. Bishop Distributing Co., 284 F.Supp. 121 (W.D. Mich. 1968); Texas National Bank of Houston v. Aufderheide*, 235 F.Supp. 599 (E.D. Ark. 1964); *United States v. United Aircraft Corp.*, 80 F.Supp. 52 (D. Conn. 1948); *In re Veterans' Air Express Co.*, 76 F.Supp. 684 (D.N.J. 1948)], and is in direct conflict with the decisions of those state courts that have decided the question.

Additionally, the decision of the Court of Appeals so erroneously interprets the Federal Aviation Act that, if left standing, it will cause chaos in the aircraft financing industry and will render meaningless the recordation provisions of the Federal Aviation Act, 49 U.S.C. §§ 1403-1406.

ARGUMENT

A Consensual Lien That Has Not Been Filed For Recordation With The Federal Aviation Administration Is Invalid Against A Subsequent Bona Fide Purchaser Without Notice.

Assuming for the purpose of this petition that Holiday did have the power to create a consensual lien on aircraft 971, petitioner submits that the consensual lien could not be enforced against him, as Holiday's trustee in bankruptcy, if it was not on file with the Federal Aviation Administration at the commencement of Holiday's bankruptcy proceeding.

It is clear that the consensual lien created by Holiday in favor of World is a "conveyance" as that term is defined in 49 U.S.C. § 1301(2):

> "As used in this chapter, unless the context otherwise requires—
>
> * * *
>
> (2) 'Conveyance' means a bill of sale, contract of conditional sale mortgage, assignment of mortgage, or other instrument affecting title to, or interest in, property."

Petitioner notes that 49 U.S.C. § 1403(a)(1), in creating a system for the recordation of interests in aircraft, provides:

> "The Secretary of Transportation shall establish and maintain a system for the recording of each and all of the following:
>
> (1) Any conveyance which affects the title to, or any interest in, any civil aircraft of the United States."

Finally, 49 U.S.C. § 1403(c) clearly and specifically states:

> "No conveyance or instrument the recording of which is provided for by subsection (a) of this section shall be valid . . . unless such conveyance or other instrument is filed for recordation in the office of the Secretary of Transportation . . . ."

The clarity of these statutory provisions makes plain that Congress intended that no instrument affecting title to aircraft would be valid against an innocent third party unless and until it is filed for recordation with the Federal Aviation Administration in Oklahoma City, Oklahoma.

Petitioner does not contend that 49 U.S.C. § 1403 preempts all aspects of state law relating to liens on aircraft. State law still determines the validity of liens and their relative priority. Thus, cases such as *Colonial Trust Co. v. Goggin*, 230

F.2d 634 (9th Cir. 1955) and *State Securities Co. v. Aviation Enterprises, Inc.*, 355 F.2d 225 (10th Cir. 1966), remain good law. The area that is preempted by 49 U.S.C. § 1403 is the manner in which consensual liens on aircraft are to be perfected. As the Tenth Circuit stated in *State Securities Co. v. Aviation Enterprises, Inc., supra:*

> "By providing a federal system for registration of conveyances and liens affecting the title to aircraft, Congress has preempted that field and state recording statutes are not applicable to such title instruments. However, questions of the validity of such title documents, actual notice, good faith purchaser status, and the like, must be resolved under state law." [355 F.2d at 229; footnotes omitted.]

The identical conclusion was reached by the Fifth Circuit in *Bank of Lexington v. Jack Adams Aircraft Sales, Inc.*, 570 F.2d 1220, 1224 (5th Cir. 1978):

> "The Federal Aviation Act created a framework for a nationwide system to record certain interests in aircraft and major aircraft components .... To the extent that state law conflicts with any part of the Act, it is preempted under the power of Congress to regulate interstate commerce .... *There is no question that Congress has preempted the field insofar as registration and recording of title instruments affecting commercial aircraft is concerned.*" [Emphasis added.]

Indeed, every court faced with the question has concluded that, absent actual notice, recordation of an instrument affecting title to aircraft with the Federal Aviation Administration is the *exclusive* manner of perfecting the claim asserted in this instrument. Contrary to the decision in this case, *a consensual lien on an aircraft cannot be perfected merely by taking possession of the aircraft.*

Most relevant is *Feldman v. Chase Manhattan Bank, N.A.*, 368 F.Supp. 1327, 1331, (S.D.N.Y. 1974), rev'd on other grounds, 511 F.2d 468 (2nd Cir. 1975):

> "Because it represents federal action in this area, section 1403 preempts, albeit not completely, those provisions of the Uniform Commercial Code which might otherwise apply as is implicitly recognized by Section 9-104 of the U.C.C. and explicitly acknowledged in the Official Comment to that section. Validation under the FAA recording system is in every respect equivalent to perfection of a security interest under the U.C.C., although, unlike the U.C.C., the FAA system provides only one way in which security interests in aircraft can be perfected. It does not envisage the variety of methods permitted for differing types of collateral." [Footnotes omitted.] .

In a footnote, the Court referred to Levie, *Security Interests in Chattel Paper*, 78 Yale L.J. 935, and then gave the following example:

> "For instance, U.C.C. § 9—305 provides for the perfection of a security interest in 'chattel paper' by the secured party taking possession of the collateral, the chattel paper itself. On the other hand, in order to perfect a security interest in 'goods,' it is necessary to file a financing statement in the state where the goods are located. See U.C.C. §§ 9—102(1), 9—302, 9—401(1)(c). The FAA recording system draws no distinctions, for purposes of perfection, among various types of collateral." [368 F.Supp. at 1331 n.9]

That open and notorious possession of an aircraft is not sufficient to perfect a claim to the aircraft without recordation with the Federal Aviation Administration is further exemplified by *Marsden v. Southern Flight Service, Inc.*, 227 F.Supp. 411, 416-417 (M.D.N.C. 1961). There, the purchaser of an aircraft took possession of the aircraft and painted its name on it in 1½ foot high letters, but did not record its title with the Federal

Aviation Administration. In holding that a subsequently recorded lien was valid against the purchaser, the Court stated:

> "We think the better view, and the one which has been taken by most of the modern courts, is that *possession alone is not sufficient to give third parties notice of the possessor's interest, especially in a context in which the property is of a kind usually protected by title papers.* To hold otherwise would be to import constructive notice into the statute by the back door. The cases are clear under the Federal Aviation Registration Act and the analogous Federal Ship Mortgage Act that the plain requirement of 'actual notice' in the statute may not be avoided in this matter." [Emphasis added]

If the Court of Appeals' decision is permitted to stand, all certainty in the aircraft financing industry will be destroyed. Contrary to the express purpose of the Federal Aviation Act—to create a single agency for the recordation of all documents affecting title to aircraft—a person claiming a consensual lien no longer must record the instrument creating the lien to make it effective against subsequent bona fide purchasers. Although 49 U.S.C. § 1403(c) says that no such unrecorded document "shall be valid in respect of such aircraft . . . against any person," the Court of Appeals in this case has held that possession of the aircraft is equivalent to recordation. With that rule in effect, a purchaser cannot check the records of the Federal Aviation Administration to ascertain the status of the title to an aircraft. Rather, he must physically locate the aircraft and personally ascertain in whose possession it is and for what reason. This cannot be the result intended by Congress.

CONCLUSION

For each of the foregoing reasons, petitioner respectfully submits that its petition should be granted.

Respectfully submitted,

By_____
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Of Counsel

FILED
June 10, 1977
__ MIN. PAST __ O'CLOCK
ROBERT L. ORDIN,
Bankruptcy Judge

_____ Deputy

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

In re

HOLIDAY AIRLINES CORPORATION, a California corporation (formerly known as Holiday Recreational Resources and Holiday Resources Corporation),

Bankrupt.

In Bankruptcy
NO. 75-02237(LTL) (RO)

CURTIS B. DANNING, Trustee in Bankruptcy of HOLIDAY AIRLINES CORPORATION, a California corporation (formerly known as Holiday Recreational Resources and Holiday Resources Corporation),

Plaintiff,

v.

WORLD AIRWAYS, INC.,

Defendant.

MEMORANDUM OPINION

This is a preference action brought by the Trustee in Bankruptcy of HOLIDAY AIRLINES COMPANY (hereinafter "HOLIDAY"). The factual background of the dispute is as follows.

1. HOLIDAY operated a scheduled commercial airline between Los Angeles and Lake Tahoe. It utilized three aircraft, identified herein as 971, 972, and 974.

2. HOLIDAY leased 971 from PETROLEUM INVESTMENT SERVICES, INC., a Colorado corporation (hereinafter "PETROLEUM"). PETROLEUM's interest in the aircraft was subject to a security interest in favor of CENTRAL BANK AND TRUST COMPANY OF DENVER, COLORADO (hereinafter "BANK").

3. WORLD AIRWAYS, INC., (hereinafter "WORLD") was engaged in the business of repairing and servicing commercial aircraft.

4. On October 7, 1974, WORLD and HOLIDAY entered into an agreement for the maintenance and servicing of HOLIDAY's aircraft. The agreement granted WORLD a lien upon aircraft in its possession to secure amounts due from HOLIDAY for services performed on such aircraft.[1]

5. On December 7, 1974, HOLIDAY delivered 971 to WORLD for servicing and maintenance. Thereafter, and prior to January 24, 1975, WORLD supplied services and maintenance to 971 of the reasonable value of $70,165.05. 971 remained continuously in WORLD's possession from December 7, 1974, to January 24, 1975.

6. WORLD did not give written notice to PETROLEUM or BANK prior to supplying services and maintenance to 971, nor was written consent of PETROLEUM or BANK sought or obtained in connection with the services or maintenance rendered by WORLD. WORLD never recorded a lien on 971 with the FAA under the Federal Aviation Act.[2]

7. By January 24, 1975, all three of HOLIDAY's aircraft were in WORLD's possession for repair and maintenance. In order to meet its schedule commitments, HOLIDAY required

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[1] *See:* Maintenance, Overhaul and Repair Agreement of October 7, 1974, Endorsement No. 2, paragraph (7).

[2] *See:* Federal Aviation Act of 1958, 49 U.S.C. 1301, et seq. (1970).

the release of one or more of these aircraft. WORLD refused to release any of the aircraft unless the amount due for services and maintenance on the released aircraft was paid or adequate collateral given to secure payment.

8. Accordingly, on January 24, 1975, HOLIDAY and WORLD entered into a transaction whereby (a) WORLD released its lien on 971 and delivered 971 to HOLIDAY; and (b) HOLIDAY executed and delivered to WORLD a chattel mortgage on 974 to secure payment of the $70,165.05 owed on 971. This chattel mortgage was filed with the FAA on January 28, 1975.

9. Ultimately 974 was sold by HOLIDAY. A portion of the proceeds of sale was used to pay WORLD the $70,165.05 incurred for services and maintenance on 971.

10. On February 13, 1975, HOLIDAY filed its Chapter XI proceedings. It was thereafter adjudicated.

The trustee asserts that the execution and delivery of the chattel mortgage on 974 and the subsequent payment of $70,165.05 constitute a voidable preference. He argues:

i. WORLD's failure to give notice and obtain consent of PETROLEUM and BANK limits the amount of WORLD's artisan's lien to $250.00. (C.C.P. 1208.61 and 1208.62.)

ii. WORLD's failure to file its claim of lien with the FAA eliminates any potential lien by consensual agreement based upon the servicing agreement of October 7, 1974.

iii. The release by WORLD of its $250.00 lien on 971 cannot support the creation of a $70,165.05 chattel mortgage on 974. The chattel mortgage constitutes a preference, at least to the extent of $69,915.05 (the difference between $70,165.05 and $250.00).

In defense of its position WORLD contends:

i. It acquired a valid possessory lien on 971. The lien is grounded on two independent bases: (a) the provisions of 1208.61; and (b) the agreement of October 7, 1974.

ii. PETROLEUM and BANK expressly authorized the services and maintenance of 971. They have never asserted, and are now estopped to assert, any $250.00 limits on charges for such service and maintenance.

iii. WORLD acquired its $70,165.05 security interest in 974 contemporaneously with the relinquishment of possession and release of its $70,165.05 lien on 971.

iv. The payment of $70,165.05 to a secured creditor under these circumstances cannot be attacked as a preference.

It is clear from the contentions of the parties and from the evidence received at the trial that all of the elements of a voidable preference have been established except the "antecedent debt" element.[3] However, if WORLD had a valid lien on 971 to secure the $70,165.05 due to it, then the chattel mortgage transaction effected a contemporaneous substitution of collateral and cannot be characterized as preferential. The terms of the lease agreement between PETROLEUM and HOLIDAY and the security agreement in favor of the BANK are pertinent to this inquiry.[4]

The provisions of the PETROLEUM-HOLIDAY lease include the following:

i. HOLIDAY obligated itself to pay rent in the sum of $11,000.00 a month; and these payments were required to be made regardless of whether the aircraft was in operational condition or was grounded for mechanical difficulties, repair, or any other reason.

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[3] Bankruptcy Act § 60a and § 60b, 11 U.S.C. 96a and 96b.

[4] See: Stipulation re Genuineness of Documents and Admissiblilty Thereof, March 18, 1977, Attachments 2, 5, 6, 7, and 8.

ii. HOLIDAY was required to return the aircraft to PETROLEUM at the termination of the lease in the same condition as when delivered, except for reasonable wear and tear, repair, and replacement of equipment.

iii. HOLIDAY was required at its own expense to maintain the aircraft in good order and repair and to replace at its own cost any and all parts, equipment, appliances, instruments, or accessories to comply with FAA operational requirements. Moreover, HOLIDAY was required to perform all engine overhaul, inspection, and maintenance service on the aircraft necessary in order to comply with FAA Air Worthiness directives which became effective during the term of the lease.

iv. In the event of HOLIDAY's default of any of the provisions of the lease, PETROLEUM could terminate the lease on 15 days' written notice.

The PETROLEUM-BANK security agreement included the following terms:

i. PETROLEUM agreed at its expense to maintain the collateral in good condition and to replace and repair all broken, worn out, or damaged parts.

ii. The security agreement was given to secure a promissory note in favor of BANK in the sum of $500,000.00. This obligation was also secured by security interests in other collateral, including oil and gas interests, common stock, and limited partnership interests of PETROLEUM.

iii. The existence of the lease on 971 in favor of HOLIDAY was acknowledged, and all rent payments due thereunder were assigned to BANK.

We are dealing here with collateral which consists of durable, costly, and complex personal property, and which requires expensive, specialized, and regular maintenance in order to retain its utility *and* its value. Moreover, the maintenance and condition of aircraft used in scheduled commercial airlines is a matter of public interest, as is manifest by the myriad of regulatory activities performed by the FAA.[5]

Neither BANK or PETROLEUM intended to provide the maintenance and service necessary to maintain 971 according to FAA standards. While the owner and mortgagee had a vital interest in the continuous and proper maintenance and condition of 971, the lease and security agreements make it clear that PETROLEUM and BANK intended and required that these burdens and responsibilities be borne by HOLIDAY. HOLIDAY, in turn, looked to WORLD to provide the requisite technical skills and physical capacities to fulfill its servicing and maintenance requirements. The trustee's arguments must be analyzed in this context.

I—*The $250.00 Limitation of 1208.62.*

§ 1208.61 and § 1208.62 of the C.C.P. deal with artisans who perform labor or furnish supplies or materiel [sic] in the service, maintenance, repair, or storage of aircraft. The artisan is given a lien dependent upon possession to secure payment of his reasonable compensation. However, his lien is limited to $250.00 when the work or services are performed at the request of one who is not the mortgagee or the holder of legal title to the aircraft. In order to obtain a lien for a sum in excess of $250.00 the artisan is required to give legal notice to and obtain written consent from the mortgagee and legal owner prior to commencement of the work.

The trustee urges that the failure of WORLD to give such written notices and obtain such written consents in the case at bar limits the lien, if any, to $250.00. In the trustee's view, the

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[5] Federal Aviation Act of 1958, 49 U.S.C. 1301, et. seq. (1970); 14 C.F.R. 49.41, et. seq.

repair facility utilized by the airline was required to engage in a continuous written dialogue with the BANK and PETROLEUM relative to the maintenance and servicing of the aircraft.

The realities of the situation refute the trustee's contention. There is no evidence that the BANK or PETROLEUM corresponded with HOLIDAY at any time with respect to the repair, maintenance, or condition of the aircraft. Having imposed the contractual duty on HOLIDAY to provide servicing and maintenance required in the operation of the commercial airliner, PETROLEUM and BANK expected HOLIDAY to make the necessary arrangements therefor. It is clear that PETROLEUM and BANK neither expected nor required notice each time a repair facility was called upon to service the aircraft. In view of the plain language of the lease and security agreements, such correspondence and dialogue would have served no useful purpose.

The FAA standard of aircraft and engine maintenance were an underlying premise upon which the continued use and value of the collateral depended. PETROLEUM and BANK knew this and sought to protect the value of the collateral and insure its continued vitality by imposing this burden on HOLIDAY. In so doing, they must be deemed to have authorized HOLIDAY to procure the requisite technical services and maintenance necessary to maintain FAA standards. This obviated the needless harassment incident to written notices from the repair facility each time a propeller hub was serviced or a hydraulic line was replaced. The trustee's contention as to the impact of § 1208.62 must be rejected.[6]

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[6] Neither PETROLEUM nor BANK have challenged the validity or extent of WORLD's lien. This distinguishes the case at bar from the facts presented in *Colonial Trust Co. v. Goggin, 230 F.2d 634 (9th Cir. 1955)*. Nor is it necessary to determine priorities under California Commercial Code 9310 as between the prior security interest of BANK and WORLD's subsequent artisan's lien.

II—*Filing The Lien With FAA.*

The failure of WORLD to comply with the filing requirements of the Federal Aviation Act is of no consequence in this proceeding. The provisions of the Federal Aviation Act and the cases interpreting it have generally held that artisan's liens are not within the mandatory recording requirements of the federal statute.[7]

The trustee seeks to avoid the implications of these authorities by asserting that: (i) WORLD's lien rights were not derived from the artisan's lien provisions of § 1208.61 but are based upon the consensual lien described in the agreement of October 7, 1974; and (ii) the perfection of a consensual lien on aircraft subject to the Federal Aviation Act must be done in the manner provided by the federal statute; and (iii) the noncompliance of the federal statute results in invalidity of the lien.

In support of this analysis, the trustee argues:

1. The Federal Aviation Act has preempted and superseded state laws with respect to the perfection of liens on federal aircraft.[8] As a consequence, liens on aircraft within the Act must be filed of record as provided by the Act.

2. While an artisan's lien is *created* by state law, its *recognition and validity* may depend upon other and completely disparate considerations; in the case at bar compliance with a preemptive federal perfection statute. To the extent that local policy embodied in

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[7] Federal Aviation Act § 1403(e) provides that no instrument shall be recorded unless it shall have been acknowledged before a notary public or other appropriate officer described in the statute; Sigman, The Wild Blue Yonder; Interests in Aircraft Under Our Federal System, 46 S.Cal. L.Rev. 316 (1973) at 322 n.27; *Continental Radio Company, Inc. v. Continental Bank & Trust Co., 369 S.W.2d 359 (Tex. Civ. App. 1963); Southern Jersey Airways, Inc. v. National Bank of Secaucus, 261 A.2d 399 (N.J. 1970); Industrial National Bank v. Butler Aviation International, Inc., 370 F.Supp. 1012 (E.D.N.Y. 1974).*

[8] See (7) supra.

> the creation of the lien conflicts with applicable perfection requirements of the FAA, the latter must control. In the case at bar, the artisan's lien cannot survive the artisan's failure to comply with the central recording requirements of the federal statute.

No doubt the trustee is correct in his assertion that the preemptive impact of the federal recording statute supersedes state law with respect to matters dealing with perfection of liens on federal aircraft.[9] However, no conflict between federal and local policy is presented here.

The artisan's lien of § 1208.61 is not within the mandatory recording provisions of the Federal Act. It presents no issue of competing policy considerations between local and federal law. The lien provisions in the agreement of October 7, 1974, are irrelevant to the issues in this case. No reason appears to deprive the artisan of his lien merely because it is referred to in written agreement between the artisan and his customer. The trustee cites no case or other authority to support the proposition that contractual recognition of the special rights of the artisan should be held to disenfranchise him of his lien rights.[10]

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[9] *1 Gilmore, Security Interest in Personal Property § 13.5 at 424 (1965); Industrial National Bank of Rhode Island v. Butler Aviation International, Inc. 370 F.Supp. 1012 n.4 (E.D.N.Y. 1974); J.C. Equipment, Inc. v. Sky Aviation, Inc. 498 S.W.2d 73 (Mo.App. 1973); Southern Jersey Airways, Inc. v. National Bank of Secaucus, 108 N.J. Super. 369, 261 A. 2d 399 (App. Div. 1970); Dowell v. Beech Acceptance Corporation, Inc. 3 Cal.3d 544, 91 Cal.Rptr. 1 (1971); Northern Illinois Corporation v. Bishop Distributing Company, 284 F.Supp. 121 (W.D. Mich. 1968); International Atlas Services, Inc. v. Twentieth Century Aircraft Company, 251 Cal.App. 2d 434, 59 Cal.Rptr. 495 (1967); Continental Radio Company, Inc. v. Continental Bank and Trust Company, 369 S.W.2d 359 (Tex. Civ. App. 1963); Blalock v. Brown, 78 Ga.App. 537, 51 S.E.2d 610 (1949); United States v. United Aircraft Corporation, 80 F.Supp. 52 (D.C.D. Conn 1948); In re Veterans' Air Express Company, Inc. 76 F.Supp. 684 (D.C. N.J. 1946).*

[10] The trustee suggests no federal or bankruptcy policy which requires a broader or different construction in derogation of the rights created in favor of the artisan under state law. (Cf. *Chicago Board of Trade v. Johnson*, 264 U.S. 1, 924.)

III—*The Exchange of Collateral.*

The transaction on January 24, 1975, accomplished a substitution of the collateral subject to WORLD's lien. The mere substitution of collateral does not create a preference ipso facto. Whether or not a preference results depends upon whether or not the transaction resulted in a depletion of the bankrupt's estate.[11] In the case at bar, WORLD held a valid artisan's lien on 971 to secure an indebtedness to it of $70,165.05. It released that lien in exchange for the chattel mortgage lien on 974. No depletion resulted to the estate. The transaction was not a preference.

This Memorandum Opinion shall constitute Findings of Fact and Conclusions of Law as provided in R.752(a). Counsel for WORLD is directed to prepare and lodge an order consistent with the foregoing.

Dated: June 10, 1977.

/s/ Robert L. Ordin

ROBERT L. ORDIN, Bankruptcy Judge

[11] 3 Collier on Bankruptcy 14th Ed. § 6020 and cases therein cited.

ENTERED

OCT 3 1978
CLERK, U.S. DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
BY DEPUTY

FILED

OCT 2 1978
CLERK, U.S. DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
BY DEPUTY

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

In the Matter of

HOLIDAY AIRLINES CORPORATION, a California corporation (formerly known as Holiday Recreational Resources and Holiday Resources Corporation),

Bankrupt.

CURTIS B. DANNING, Trustee in Bankruptcy of HOLIDAY AIRLINES CORPORATION, a California corporation (formerly known as Holiday Recreational Resources and Holiday Resources Corporation),

Plaintiff-Appellant,

vs.

WORLD AIRWAYS, INC.,

Defendant-Appellee.

Bankruptcy Case No.
BK-75-02237-RLO-LTL
(CV-77-2937-LTL)

MEMORANDUM OF DECISION

This is an appeal from a Memorandum Opinion filed June 10, 1977 and a Judgment entered July 8, 1977 by the Bankruptcy Judge in bankruptcy proceedings involving Holiday Airlines Corporation (Holiday). The specific proceeding involving here is one brought by appellant Curtis B. Danning, Holiday's Trustee in Bankruptcy (Trustee), to recover an alleged preference given defendant-appellee World Airways,

Inc. (World). At the trial of the action, the Bankruptcy Judge granted World's motion to dismiss at the conclusion of the Trustee's case because of Trustee's failure to prove one of the elements necessary to show a preference that there was an antecedent debt.

The underlying facts are not in dispute. Holiday was an air carrier. World is a corporation which performs aircraft servicing and maintenance. On October 7, 1974 Holiday and World entered into a maintenance agreement. On December 7, 1974 Holiday delivered to World a Lockheed Electra aircraft No. N-971-HA (971) for servicing. 971, under lease to Holiday, was owned by Petroleum Investment Services, Inc. (Petroleum Services) subject to a security interest in favor of Central Bank and Trust Co. (Central Bank). World supplied services on 971 valued at $70,165.05.

On January 24, 1975 World released 971 to Holiday. To secure the debt owing to World, Holiday shortly thereafter executed a mortgage in favor of World on another plane, No. 974-HA (974) which was wholly owned by Holiday and at the time was in World's possession for repair and maintenance. 974 soon thereafter was sold by Holiday with World receiving payment on January 31, 1975 from the proceeds of such sale for the work done on 971. The mortgage was then released. The mortgage was recorded on February 8, 1975. On February 13, 1975 Holiday filed under Chapter XI and was subsequently adjudicated bankrupt.

Jurisdiction here is found in 11 U.S.C. § 67(c).

Under California Code of Civil Procedure § 1208.61, a repairer has a lien dependent on possession for repairs made on an aircraft. Under California Code of Civil Procedure § 1208.62, that lien is in some circumstances limited to $250.00. Appellant Trustee contends on appeal that the Bankruptcy Court made an error of law by holding that World had a valid lien on 971 to secure the $70,165.05 debt since World had not complied with the above sections of the California Code of

Civil Procedure. Specifically the Trustee argues that when the Bankruptcy Court held that Petroleum Services and Central Bank had waived notice and consent requirements as to the lien, it overlooked provisions of the lease from Petroleum Services and the mortgage of Central Bank saying that no liens would be allowed. The Trustee also argues that such waiver is impermissible and, since the California Code of Civil Procedure was not complied with, for either of the reasons stated any claim by World is limited to $250.00.

Alternatively, Trustee contends that if the lien was consensual it was never perfected since it was never recorded with the Federal Aviation Administration as required by 49 U.S.C. § 1403(c), at least as to third parties without notice.

Finally, the Trustee argues that even if the lien was valid under the California Code of Civil Procedure it was nevertheless relinquished when World gave back 971 to Holiday several hours before the 974 mortgage was executed; that World was for that time an unsecured creditor; and that World thus received a payment on an antecedent debt when it received the payment from Holiday.

Bankruptcy Rule 741 makes Federal Rule of Civil Procedure 41 applicable to adversary proceedings in bankruptcy. FRCP 41(b) allows a court as trier of the facts to render judgment at the close of plaintiff's case in response to defendant's motion to dismiss where plaintiff has shown no right to relief on the facts and the law. On such a motion, the Bankruptcy Court is not required to view the evidence in a light most favorable to Trustee to see if a prima facie case was made out, but rather can render judgment if it is convinced from the record as it stood at the close of Trustee's case that the evidence preponderated against Trustee. *See Ellis v. Carter* 328 F.2d 573, 577 (9th Cir. 1964).

Appeal from such a judgment is covered by Bankruptcy Rule 810, which states:

"Upon an appeal the district court may affirm modify, or reverse a referee's judgment or order or remand with instructions for further proceedings. The court shall accept the referee's findings of fact unless they are clearly erroneous, and shall give due regard to the opportunity of the referee to judge of the credibility of the witnesses."

A preference is defined in 11 U.S.C. § 96 (§ 60 of the Bankruptcy Act) as follows:

"(a)(1) A preference is a transfer, as defined in this title, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this title, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class."

(2) For the purposes of subdivisions (a) and (b) of this section, a transfer of property other than real property shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee . . . If any transfer of real property is not so perfected against a bona fide purchase, or if any transfer of other property is not so perfected against such liens by legal or equitable proceedings prior to the filing of a petition initiating a proceeding under this title, it shall be deemed to have been made immediately before the filing of the petition."

Here the Bankruptcy Judge found that no antecedent debt existed. Instead he found that a valid lien existed when the payment by Holiday to World was made and that the transfer of property in satisfaction of that statutory lien was not a preference. *See* 11 U.S.C. § 107(b); *Greenblatt v. Utley* (9th

Cir. 1956) 240 F.2d 243; 3 Collier on Bankruptcy II, §§ 60.12, 60.22 and 60.47.

The primary question on appeal is whether a valid lien in the amount of the payment made by the bankrupt to Holiday existed at the time the payment was made. Such a lien could arise from either statutory provisions for artisan's liens on aircraft or consensually from provisions in the contract between World and Holiday.

In our view the judgment of the Bankruptcy Court cannot be affirmed because its findings that no antecedent debt existed and that a valid lien existed at the time the questioned payment was made were clearly erroneous.

Its holding that notice and consent to a statutory lien by Central Bank and Petroleum Services were implicit in the agreements between Holiday, Central Bank and Petroleum Services is clearly unwarranted in view of the statements in those agreements that no liens were permitted. In looking at the "realities" and finding a statutory lien, the Bankruptcy Judge finds something that isn't there. *See Colonial Trust Co. v. Goggin* 230 F.2d 634 (9th Cir. 1955). While the Bankruptcy Court has the power to disregard form for substance, it may not impose a result not contemplated by the statutory scheme and the clear language of the agreements between Holiday, Petroleum Services and Central Bank. *In re Ahlswede* 516 F.2d 784, 787 (9th Cir. 1975), *cert. den.* 423 U.S. 913. The statutory lien here accordingly is limited to $250.00 and any payment in excess thereof is a preference as a payment on an unsecured antecedent debt unless a consensual lien can be shown.

Although there may be a question as to whether a provision in the contract between Holiday and World created a consensual lien, the Bankruptcy Judge ultimately assumed in his Memorandum Opinion that this was merely an embodiment of the statutory lien. A consensual lien merely embodying a statutory lien is no better than the underlying statutory lien which we have found here to be invalid.

In any event, even if a consensual lien was intended by the contracting parties, such lien was never recorded and thus is invalid under 49 U.S.C. § 1403(c) as to third parties without notice. In terms of preference analysis, such lien was therefore perfected only when the petition in bankruptcy was filed [*see* 11 U.S.C. § 96(a)(2)] and the granting of the lien was a transfer on account of an antecedent debt. The payment made before the lien was perfected was also a transfer on account of an antecedent debt.

The decision of the Bankruptcy Judge in granting the motion to dismiss of World at the conclusion of the Trustee's case is reversed. The matter is remanded to the Bankruptcy Court for further proceedings consistent herewith.

DATED: September 28, 1978

/s/ Lawrence T. Lydick

LAWRENCE T. LYDICK
United States District Judge

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In the Matter of:

HOLIDAY AIRLINES CORPORATION, a California corporation (formerly known as Holiday Recreational Resources and Holiday Resources Corporation),

Bankrupt.

CURTIS B. DANNING, Trustee in Bankruptcy of HOLIDAY AIRLINES CORPORATION, a California corporation (formerly known as Holiday Recreational Resources and Holiday Resources Corporation),

Plaintiff-Appellee,

vs.

WORLD AIRWAYS, INC.,

Defendant-Appellant.

No. 79-3148

Argued and Submitted Dec. 3, 1980
Decided June 8, 1981

Appeal from the United States District Court for the Central District of California.

Before GIBSON*, SNEED and POOLE, Circuit Judges.

SNEED, Circuit Judge:

This is a bankruptcy case in which the issue is whether World Airways, Inc., a creditor of the bankrupt Holiday Airlines Corporation, Inc., received a preference recoverable by

*Honorable Floyd R. Gibson, Senior United States Circuit Judge for the Eighth Circuit, sitting by designation.

Holiday's Trustee in bankruptcy when it received payment for services and maintenance on a Lockheed-Electra aircraft, No. N-971-HA (971), which was under lease to Holiday, from the proceeds derived from the sale of another aircraft, No. N-974-HA (974), which was owned by Holiday. If the receipt by World of this payment were merely the proceeds from the liquidation of its previously perfected security interest, which itself was immune from an attack by Holiday's Trustee, it would not be a preference. On the other hand, if it were a payment from proceeds, to which it had no claim better than that of a general creditor, to discharge the antecedent debt that arose from its services and maintenance with respect to aircraft 971, it would be a preference. We hold that the former is the proper characterization and that the payment was not a preference. Therefore, we reverse the judgment of the district court and remand this case to that court for further proceedings consistent with this holding and the opinion that follows.

I

FACTS

Aircraft 971 was leased to Holiday by Petroleum Investment Services, Inc. and was subject to a security interest in favor of the Central Bank and Trust Company of Denver, Colorado. The agreement between Petroleum and Holiday provides that Holiday was required at its own expense to maintain the aircraft in good order and repair and to perform such maintenance and inspection as necessary to comply with FAA Air Worthiness directives. Petroleum assigned Holiday's rental payments to the Denver bank presumably to be applied against the debt secured by the bank's security interest in aircraft 971.

On October 7, 1973 Holiday entered into what was designated a Maintenance, Overhaul and Repair Agreement with World for the purpose of servicing Holiday's aircraft. The Agreement contained the following provision:

> "[World] shall have a lien upon customer's aircraft and components for the value of all services furnished, including, without limitation, reasonable compensation for storage incurred by [World] by reason of customer's failure to accept delivery of aircraft or other flight equipment." Endorsement No. 2, paragraph (7).

On December 7, 1974, Holiday delivered aircraft 971 to World for servicing and maintenance and World supplied services and maintenance which had a reasonable value of $70,165.05. Aircraft 971 remained continuously in World's possession from the date of its delivery to January 24, 1975. World did not give written notice to Petroleum or the Denver bank prior to supplying these services, nor was written consent of either sought or obtained in connection with these services. World never attempted to record its lien on aircraft 971 with the Federal Aviation Administration pursuant to 49 U.S.C. § 1403.

On January 24, 1975 all of Holiday's aircraft, including both 971 and 974, were in World's possession for servicing. To meet its schedule commitments Holiday needed to obtain the release of at least some of its aircraft but World would release none unless payment for services was made or adequate security to assure such payment was made. To solve this problem it was agreed that World would surrender possession of aircraft 971 and Holiday would execute and deliver to World a chattel mortgage on aircraft 974 to secure the $70,165.05 owed with respect to aircraft 971. This was accomplished in January 24, 1975. However, possession of aircraft 971 was surrendered several hours before the chattel mortgage on aircraft 974 was executed and delivered. This chattel mortgage was recorded pursuant to 49 U.S.C. § 1403 on January 28, 1975.

Aircraft 974 was sold immediately thereafter and World received payment on January 31, 1975 of the $70,165.05 due for servicing aircraft 971. The end for the purposes of this case came shortly thereafter. On February 13, 1975 Holiday filed under Chap. XI and subsequently was adjudicated bankrupt.

To support his contention that the payment to World of $70,165.05 was a preference the Trustee contends that World had no valid perfected lien on aircraft 971 with the consequence that the chattel mortgage on aircraft 974 and the resulting payment were in discharge of an antecedent debt. World disputes this vigorously. It argues that a valid perfected lien on aircraft 971 existed from the time it serviced the aircraft. The lien's validity, World asserts, rests on either Cal.Civ.Pro.Code § 1208.61 and § 1208.62 or Cal.Com.Code § 9305. The Trustee responds by contending (1) that a failure to record World's lien pursuant to 49 U.S.C. § 1403 left it unperfected, (2) that in any event World's lien was invalid, except to the extent of $250, under Cal.Civ.Pro.Code § 1208.62, because no notice was given to either Petroleum or the Denver bank prior to commencing to service aircraft 971 and no written consent to do the work was obtained from either, (3) that no consensual lien perfected by possession pursuant to Cal.Com.Code § 9305 exists, and (4) that should one exist it was surrendered prior to the execution of the chattel mortgage on aircraft 974 and the payment of $70,165.05 by Holiday.

Inasmuch as we hold that a valid consensual lien perfected by possession did exist and that the gap of a few hours between the surrender of possession of aircraft 971 and the execution of the chattel mortgage on aircraft 974 is without legal significance for the purpose of this case, there exists no reason for us to address the questions raised by the trustee concerning a lien asserted pursuant to Cal.Civ.Pro.Code §1208.62. We also hold that World's consensual lien perfected by possession is not invalid for failure to be recorded pursuant to 49 U.S.C. § 1403.

II

THE EFFECT OF FAILURE TO RECORD PURSUANT TO 49 U.S.C. § 1403

The Trustee is correct when he contends that a preference exists if recordation by World under 49 U.S.C. § 1403 is necessary to perfect its lien on aircraft 971. Section 1403(c)

provides some support for the position that such recordation is necessary. It states that "no conveyance or instrument," able to be recorded under the act, "shall be valid in respect of such aircraft . . . against any person," other than the parties to the conveyance or instrument," until such conveyance or other instrument is filed . . ."

Section 1403 does not preempt local law to the full extent that this extract might suggest. The court observed in *Colonial Trust Co. v. Goggin*, 230 F.2d 634, 637 (9th Cir. 1955), that, notwithstanding the federal recordation system, "where an article of personal property of whatever character is in possession of one who has expended work and labor thereon at the request of the person lawfully in possession, the domestic law of the place of possession governs as to the extent and character of the lien." A similar view has been expressed in *State Securities Company v. Aviation Enterprises, Inc.*, 355 F.2d 225, 229 (10th Cir. 1966). Several decisions upholding the rights of a purchaser in the ordinary course of business under state law as against holders of floor plan financing liens recorded under federal law employ the same approach. *See Sanders v. Aircraft Sales Inc.*, 575 F.2d 1086 (3d Cir. 1978); *Haynes v. General Electric Credit Corporation*, 582 F.2d 869 (4th Cir. 1978). Both *Sanders* and *Haynes* declined to read section 1406 so as to preempt provisions of the relevant state's version of the Uniform Commercial Code which were designed to protect purchasers in the ordinary course of business. The Supreme Court of California has reached the opposite conclusion. *See Dowell v. Beech Acceptance Corp., Inc.*, 3 Cal.3d 544, 91 Cal.Rptr. 1, 476 P.2d 401 (1970). The financing agency prevailed over the buyer in the ordinary course of business because of the preemptive effect accorded section 1406 by the California court.

Despite the reference of 49 U.S.C. § 1406 to state law as determining the validity of liens recorded under section 1403, we are not bound by state court decisions on the preemptive effect of federal law.[1] *Shell Oil Co. v. Younger*, 587 F.2d 34,

[1] We, of course, express no opinion on the effect of state decisions on preemption in diversity cases.

36-37 (9th Cir. 1978)(California Supreme Court decision interpreting the preemptive scope of the Sherman Act not controlling in a case construing a similar state statute and its preemption by the Sherman Act); *Clifton v. Cox*, 549 F.2d 722, 730 (9th Cir. 1977)(state courts have no power to bind the federal courts with their rulings concerning the extent of federal power); *see Flournoy v. Wiener*, 321 U.S. 253, 270-72, 64 S.Ct. 548, 556-57, 88 L.Ed. 708 (1944)(Frankfurter, J., dissenting)(construction of federal law necessary to decision under state law gives rise to a federal question); *Standard Oil of California v. Johnson*, 316 U.S. 481, 62 S.Ct. 1168, 86 L.Ed. 1611 (1942); *Smith v. Kansas City Title & Trust Co.*, 255 U.S. 180, 41 S.Ct. 243, 65 L.Ed. 577 (1921). We hold that the failure of World to record its consensual lien on aircraft 971 while in its possession under the circumstances of this case does not make perfection of its lien impossible as a matter of federal law. This holding is limited to consensual liens perfected by possession. It does not embrace consensual liens when the lienholder is not in possession. Perfection of such liens will require recording under 49 U.S.C. § 1406.

III

WORLD'S CONSENSUAL LIEN PERFECTED BY POSSESSION

The question remaining is whether, absent any preemptive effect of sections 1403 and 1406, a consensual lienholder who has not recorded his lien and is in possession of an airplane has an interest under California law that is superior to any lien that is "obtainable by legal or equitable proceedings" on a simple contract. Section 60(a)(2) Bankruptcy Act, 11 U.S.C. § 96 (1976). A demonstration is now necessary that, under California law, World held a consensual lien on aircraft 971 perfected by possession. The Maintenance, Overhaul and Repair Agreement set out above clearly indicates that a lien for services, repairs, and any storage was intended. Both the bankruptcy judge and the district court treated this provision as but a

reference to the statutory lien provided by Cal.Civ.Pro.Code § 1208.61 and § 1208.62. Therefore, both were compelled to determine whether World's statutory lien had been perfected beyond the minimal amount of $250. As to this they differed, the bankruptcy judge holding that it had and the district court that it had not.

We hold that it was clearly erroneous to disregard the plain language of the Agreement between Holiday and World and to treat the lien provision as surplusage in effect. Without tarrying to determine whether this treatment of the lien provision by both the bankruptcy judge and the district court was a finding of fact, a conclusion of law, or a mixed question of law and fact, we have a sufficiently firm conviction that it is wrong to require that we proceed differently. The more natural and normal reading of the lien provisions in the Agreement is that World was to have a lien for its services to the full extent that an explicit agreement to that effect would permit under California law. This would embrace *both* the statutory and a consensual lien. Expressed colloquially, we read the Agreement as providing World a lien for its services by any, and all, means available under California law.

The framework within which a consensual lien, such as World asserts, functions under California law is provided by Article 9 of California's version of the Uniform Commercial Code. Section 9102(1)(a), Cal.Comm.Code, provides that "Division 9" applies "To any transaction (regardless of form) which is intended to create a security interest in personal property, including goods . . ." The term "goods" is defined to include "all things which are movable at the time the security interest attaches. . . .," Cal.Comm.Code, § 9105(1)(f), which clearly embraces aircraft 971. More specifically, the aircraft fell within the definition of "equipment" set forth in Cal.Comm.Code § 9109 because it was goods "used or bought for use primarily in business. . ." perfection of a "security interest" in "goods," under Cal.Comm.Code § 9305, may be achieved by "the secured party's taking possession of the

collateral." This is, of course, precisely what World did with respect to aircraft 971. This perfection commences when "possession is taken without relation back and continues only so long as possession is retained. . ." *Ibid.* A perfected security interest is not subordinate to a subsequent lien creditor. *See* Cal.Comm.Code § 9301(1)(b).

Without question World is entitled to its agreed upon "security interest" which it perfected by taking possession of the "goods." Nor does the existence of the statutory lien for repairs on aircraft provided by Cal.Civ.Pro. Code § 120.61 and § 1208.62 preclude the operation of "Division 9" of the commercial Code. While it is true that "Division 9" does not preempt section 1208.61 and 1208.62 liens, *see* Cal.Comm.Code § 9104(c), it is also true that there exists no indication these statutory liens are intended to preclude the application to aircraft of those provisions of "Division 9" not in conflict thereto.

Thus, we hold that World possessed a consensual lien to secure its services and maintenance with respect to aircraft 971 perfected by possession and recognized by California law.[2]

It has not been suggested by the parties that this holding would impinge in any way upon the interests of either Petroleum Investment Services, Inc. or Central Bank and Trust Co. Had such a suggestion been made it might have been necessary to consider the effect of Holiday's undertaking in its agreement with Petroleum to maintain the aircraft in good order and repair. However, under the circumstances of this case no such examination is necessary.

IV

THE "GAP" PROBLEM

Inasmuch as World's lien on aircraft 971 lost its perfected status on January 24, 1975 when possession of this aircraft was surrendered to Holiday several hours before the chattel mortgage on aircraft 974 was executed, it is possible to argue that

[2] We decline to believe that the California Supreme Court would interpret its holding in *Dowell v. Beech Acceptance Corp., supra,* as decision based on state law so as to reverse this result.

execution of the mortgage and payment of $70,165.05 to World was in discharge of an antecedent debt and did cause a diminution of Holiday's estate. It would be pointed out that, rather than a mere *substitution* of security occurring, the proper characterization is that the chattel mortgage *replaced* perfected security previously surrendered.

The *replacement* characterization exalts form over substance. A similar analysis, also employed to claim that the creation of a security interest amounted to a preference, has been rejected when, to secure a current advance, the instrument creating the previously agreed upon security interest was executed several days after the date of the advance. *Dean v. Davis*, 242 U.S. 438, 37 S.Ct. 130, 61 L.Ed. 419 (1917). Substantial contemporaneity appears to be all that is required. *Id* at 443, 37 S.Ct. at 131. The proper characterization, therefore, is that the events of January 24, 1975 constituted a *substitution* of one security for another. This did not amount to a preference where no diminution of the debtor's estate occurred. *See* 4 Collier on Bankruptcy, § 547.22 (1980). None such occurred here.[3] We hold that the so-called "gap" on January 24, 1975 generated no preference.

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[3] The determination of whether such an exchange constitutes a preference turns on whether it results in a diminution of the bankrupt's estate, not on whether or not the creditor's security was enhanced. 4 Collier on Bankruptcy ¶ 547.22 (1980). Prior to the exchange, Holiday's estate contained (1) its ownership interest in aircraft 974 and (2) its leasehold interest in aircraft 971 encumbered by a lien for $70,165.05. After the exchange, Holiday's estate contained (a) its ownership interest in aircraft 974 encumbered by a chattel mortgage for $70,165.05 and (b) its leasehold interest in aircraft 971. If the sum of the latter two values is greater than or equal to the sum of the two former values, there was no preference. Put another way, if value (b) was less than $70,165.05, there was a preference. *See In re Star Spring Bed Co.*, 265 F. 133 (3d Cir. 1920). No finding appears to have been made below concerning the value of Holiday's leasehold in aircraft 971. However, because of the bankruptcy court's finding that there was no preference and the failure of either the parties or the district court to raise the issue of the value of Holiday's leasehold, we assume that its value was greater than $70,165.05.

National City Bank v. Hotchkiss, 231 U.S. 50, 34 S.Ct. 20, 58 L.Ed 115 (1913), does not require a different holding. There the Court found a preference when creation of the security interest followed the advance because at the time of the advance no security was considered necessary. The rapid deterioration of the debtor activated the desire to obtain security. Nothing of this sort occurred here. A substitution of security was contemplated from the beginning. *Dean v. Davis, supra*, not *National City Bank v. Hotchkiss, supra*, governs this case.

Finally, we note that, because World's chattel mortgage was recorded pursuant to 49 U.S.C. § 1403, the payment to World of $70,165.05 was not be discharge an unperfected lien and was, hence, not a preference.

Reversed and Remanded.

GIBSON, Senior Circuit Judge, concurring.

I concur in Judge Sneed's opinion. My rationale for finding a valid consensual lien is that Holiday had sufficient "rights in the collateral," Cal.Comm.Code § 9204, to enter into a security agreement with World Airways for the limited purpose of obtaining services and maintenance on the aircraft. While a leasehold may not be a sufficient interest upon which to ordinarily allow the lessee to base a security interest, as outlined in Judge Poole's dissenting opinion, the lease agreement between Petroleum and Holiday did provide that Holiday was required at its own expense to maintain the aircraft. Holiday remained liable for the cost of repairs. The lessee had an implied right, therefore, to place the aircraft in the possession of a third party for the purpose of obtaining reasonable repairs which could give rise to a mechanic's lien. Rarely are repairs, particularly of this magnitude, paid for in advance. Maintenance of the plane in good working order, furthermore, is obviously beneficial to both the lessor and the lessee. Third party creditors' rights and security interests might also be impaired if the aircraft were allowed to fall into a state of disrepair.

POOLE, Circuit Judge, dissenting.

I respectfully dissent. In my view, under the provisions of California law relied upon by the majority, Holiday Airlines, Inc. (Holiday) lacked the power to consent to the creation of a security interest in an aircraft which it did not own. Therefore, the consensual lien which Holiday attempted to grant to World Airways, Inc. (World) never attached to aircraft 971; World perfected by possession only that which it was granted, to wit, an unattached, ineffective lien. As World had no valid, perfected lien in 971, the security interest which it acquired through substitution in aircraft 974 was preferential within the meaning of § 60 of the Bankruptcy Act, 11 U.S.C. § 96 (1976), and the judgment of the district court should be affirmed.

In part III the majority concludes that the repair agreement between Holiday, lessee of 971, and World, the repairman, created a consensual lien under California law which World perfected when it took 971 into its possession. *See* Cal.Comm.Code §§ 9204, 9305; Maj. op., at 981. This provision of the repair contract, set out at page 978 of the majority opinion, is not the only part of the record before us relevant to determining the validity of World's alleged consensual lien. Holiday was the lessee of 971. Its possessory rights stemmed from a lease agreement with Petroleum Investment Services, Inc. (Petroleum), the owner, which provides that Holiday had no power to permit any lien or encumbrance to arise on 971.[1] Holiday's status as a lessee and this explicit prohibition on encumbrance of 971 undermine the majority theory that under California law a consensual lien arose by virtue of the repair agreement.

In order to establish a consensual lien against one who is not a party to the agreement creating the disputed security interest, the interest must attach to the collateral and be

[1] The lease between Petroleum and Holiday reads:
THIRTEENTH—LESSEE shall have no right to consent to, allow, or permit any liens or encumbrances on said AIRCRAFT.

perfected. There is no doubt that whatever interest World obtained became perfected under California law when it took possession of 971. Cal.Comm.Code § 9305. However, World could perfect only that interest which had attached to 971 and which Holiday had the power to cause to attach. If Holiday lacked the power to impress a lien on 971, then no interest ever attached in the aircraft and World could have perfected by possession only an ineffective, unattached interest. This is our case.

Mere recitation of the security interest in the repair contract is insufficient to establish that the interest attached to 971. *See Chartered Bank of London v. Chrysler Corp.*, 115 Cal. App.3d 755, 760, 171 Cal.Rptr. 748, 750 (1981). Rather in order for a security interest to attach in a chattel, there must be "an agreement . . . that it attach and value is given and the debtor has rights in the collateral." Cal.Comm.Code § 9204. The majority's analysis of § 9204 is faulty because World cannot demonstrate on this record that Holiday possessed sufficient "rights in the collateral," 971, to encumber it by consensual agreement. *See Chartered Bank, supra* (party asserting validity of a security interest will be required to show that debtor had "rights in the collateral" sufficient to create the interest).

Certainly an owner may encumber his property and subject it to a consensual security interest. Holiday, however, is not an owner, but a lessee. Under Article 9, a lessee may generally not encumber his lessor's property. *See, e.g., Disch v. Raven Transfer & Storage Co.*, 17 Wash.App. 73, 561 P.2d 1097 (1977).[2] The majority does not dispute, nor does it purport to

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[2] *See generally* Annivino, *When Does a Debtor Have Rights in the Collateral Under Article 9 of the Uniform Commercial Code*, 61 Marq. L.Rev. 23, 29-31 (1977).

alter this rule. Holiday's status as a lessee thus gives it no more than a lawful right to possession of 971, not the power to employ the aircraft as security.[3]

Notwithstanding its lessee status, Holiday could create a lien in 971 if Petroleum had authorized Holiday to enter into a consensual lien agreement. Under California law,

> [a] debtor who does not own collateral may nonetheless use the collateral for security, thereby obtaining rights in the collateral, when authorized to do so by the actual owner of the collateral.

K. N. C. Wholesale, Inc. v. AWMCO, Inc., 56 Cal.App.3d 315, 31819, 128 Cal.Rptr. 345, 348 (1976); *accord, Matter of Pubs, Inc. of Champaign*, 618 F.2d 432, 436 (7th Cir. 1980) (under Article 9, a lessee may have rights in collateral and encumber a lessor's chattel when lessor has expressly or implicitly authorized creation of the security interest).

On this record, it is impossible to find that Petroleum gave Holiday the power to encumber 971. The lease agreement expressly withdraws such power from Holiday. Petroleum never approved the repair agreement executed between Holiday and World nor has it taken any action which suggests its acquiescence in the creation of a lien by its lessee. When the right to pledge a chattel as security has been withheld by the owner, it is unreasonable to give effect to an attempt by a lessee to create such an interest.

The majority attempts to define away the difficulties presented to its analysis by the "rights in collateral" requirement of Cal.Comm.Code § 9204. At page 981, the opinion

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[3] It may be that a lessee has sufficient rights in a chattel to pledge it as collateral when the lease is designed to be a security interest or financing device rather than a traditional leasehold. *See* Anzivino, *supra*. There is no need to consider this possibility in this case because the parties clearly indicated that Holiday acquired no title or security interest in 971 by virtue of the lease. Similarly, nothing in any provision of the lease suggests that anything other than a traditional leasehold was created.

indicates that there is no suggestion in this case that the rights of Petroleum or the mortgagor of 971, Central Bank & Trust Co., are in any way impinged by the majority's holding and that if there were such a prospect a different case would be presented. This dubious observation overlooks that "[f]undamental to a secured party's acquisition of a security interest in property of the debtor is that the debtor have 'rights in the collateral.'" *Anthony v. Community Loan & Investment Corp.*, 559 F.2d 1363, 1368, *reh'g. denied*, 564 F.2d 416 (5th Cir. 1977).

Under Cal.Comm.Code § 9204, it is elementary that the existence of a valid security interest in 971 turns on whether Holiday had "rights in the collateral" which enabled it to pledge the aircraft. One cannot dispense with this requirement simply because the owner is not challenging the validity of the security interest a lessee attempted to create.

In his concurring opinion, Judge Gibson suggests that the necessary "rights in collateral" arise by virtue of the Petroleum-Holiday lease provision whereby Holiday must maintain 971 at its own expense and in accord with federal aviation standards. Judge Gibson would read this provision to mean "[t]he lessee had an implied right . . . to place the aircraft in the possession of a third party which could give rise to a mechanic's lien." Concurring Opinion. I cannot agree that the law of California permits us to imply this new covenant into the Petroleum-Holiday agreement.

Implied covenants are disfavored and the California Supreme Court has identified five factors which should be present before a covenant will be implied:

> (1) the implication must arise from the language used or it must be indispensable to effectuate the intention of the parties; (2) it must appear from the language used that it was so clearly within the contemplation of the parties that they deemed it unnecessary to express it; (3) implied covenants can only be justified on the grounds of legal necessity; (4) a promise can be implied only where it can

be rightfully assumed that it would have been made if attention had been called to it; (5) there can be no implied covenant where the subject is completely covered by the contract.

See, e.g., Stockton Dry Goods Co. v. Girsh, 36 Cal.2d 677, 681, 227 P.2d 1 (1951); Cal.Civ.Code § 1648.

Applying these standards, it is certainly not indispensable to a lessee's obligation to repair an airplane that the lessee have power to encumber the aircraft. The record here belies the prospect that the parties so clearly contemplated Holiday's power to encumber 971 for repairs that they thought it unnecessary to include such a provision in the lease. If it is legally necessary or sound policy to vindicate an aircraft repairman's lien, then it is for California's legislature to provide such protection, as has been done in Cal.Civ.Pro.Code §§ 1208.61, .62. The presence of this statutory aircraft repairman's lien makes it legally unnecessary to imply such a lien to a clear, consensual agreement. Finally, I doubt that we have the power under California law to imply a contract term which is contrary to the express terms of the parties' understanding. Petroleum and Holiday agree that Holiday was to have no power to consent to the creation of any liens in 971 and I am not willing to disregard this clear expression of their intention. I cannot embrace the "implied right" theory of the concurring opinion.

As the majority erroneously concludes that World acquired a valid consensual lien on 971 from Holiday under Cal.Comm. Code § 9204, I must conclude that the majority opinion provides an insufficient basis to reverse the judgment of the district court. I would affirm.[4]

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[4] As World never acquired a consensual lien that attached in 971 by virtue of the repair agreement, I find it unnecessary to consider, and express no view on, the preemptive effect of the Federal Aviation Act on consensual security interests created and perfected pursuant to provisions of the Uniform Commercial Code. Similarly, no useful purpose would be served by considering in this dissent other possible bases whereby World might have acquired a lien on 971. I dissent because the majority fails to provide an adequate legal basis to reverse the judgment of the district court.

FILED
JUL 21 1981

RICHARD S. DEANE
Clerk, U.S. COURT OF APPEALS

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In the Matter of:

HOLIDAY AIRLINES CORPORATION, a California corporation (formerly known as Holiday Recreational Resources and Holiday Resources Corporation),

Bankrupt,

CURTIS B. DANNING, Trustee in Bankruptcy of HOLIDAY AIRLINES CORPORATION, a California corporation (formerly known as Holiday Recreational Resources and Holiday Resources Corporation),

Plaintiff-Appellee,

vs.

WORLD AIRWAYS, INC.,

Defendant-Appellant.

No. 79-3148

ORDER

Before: GIBSON*, SNEED and POOLE, Circuit Judges

Judges Gibson and Sneed have voted to deny and Judge Poole has voted to grant Appellee's petition for rehearing. The petition for rehearing is denied.

*Honorable Floyd R. Gibson, Senior United States Circuit Judge for the Eighth Circuit, sitting by designation.

Opposition

Office-Supreme Court, U.S.
FILED
NOV 24 1981
ALEXANDER L. STEVAS,
CLERK

No. 81-821

IN THE

Supreme Court of the United States

October Term 1981

In re HOLIDAY AIRLINES CORPORATION, a California corporation (formerly known as Holiday Recreational Resources and Holiday Resources Corporation),

Bankrupt.

CURTIS B. DANNING, Trustee in Bankruptcy of HOLIDAY AIRLINES CORPORATION, a California corporation (formerly known as Holiday Recreational Resources and Holiday Resources Corporation),

VS.

WORLD AIRWAYS, INC.

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTION PRESENTED

Whether an entity which performs services on an aircraft and obtains a lien for the value of its services may perfect its lien by possession of the collateral as well as by recordation of the lien pursuant to the provisions of the Federal Aviation Act?

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Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Irving Sulmeyer, counsel for World Airways, Inc., Respondent, hereby respectfully submits its Brief In Opposition to Curtis B. Danning's Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit.

STATUTES INVOLVED

The following statutory provisions are involved in this case:

49 U.S.C. § 1403(c)

"No conveyance or instrument the recording of which is provided for by subsection (a) of this section shall be valid . . . against any person other than . . . any person having actual notice thereof . . . unless such conveyance or other instrument is filed for recordation in the office of the Secretary of Transportation . . . ."

49 U.S.C. § 1406

"The validity of any instrument the recording of which is provided for by section 1403 of this title shall be governed by the laws of the State, District of Columbia, or territory or possession of the United States in which such instrument is delivered, irrespective of the location or place of delivery of the property which is the subject of such instrument."

SUMMARY OF ARGUMENT

In order to convince this Court to issue a writ of certiorari, Petitioner incorrectly states the holding of the Ninth Circuit, thereby manufacturing a fictional conflict among Federal Courts of Appeals and among other courts.

The Ninth Circuit held that an entity which performs services on an aircraft and obtains a lien for the value of its services may perfect its lien by possession of the collateral as well as by recordation of the lien pursuant to the provisions of the Federal Aviation Act. Petitioner's version of the Ninth Circuit's holding is "that Congress has not premepted [sic] the field of recordation of interests in aircraft and that a consensual lien on an aircraft may be perfected against a subsequent bona fide purchaser without notice in the absence of recordation of

the lien with the Federal Aviation Administration . . ." *Petition* at 9. To the contrary, the Ninth Circuit recognized the preemptive effect of the Federal Aviation Act and carefully analyzed the extent to which this federal law preempts state law. The Court also did not hold that an unrecorded lien may be "perfected against" a bona fide purchaser. The Court discussed the rights and powers of the Trustee as a judicial lien creditor. In holding Respondent's lien superior to the rights of the Trustee, the Court was not presented with the issue, and accordingly did not decide the issue, of the competing rights of a bona fide purchaser and a holder of a consensual lien perfected by possession.

Once the holding of the Ninth Circuit is correctly stated, the cases cited by Petitioner as establishing a conflict are seen to be irrelevant to, distinguishable from, or strongly supportive of the Ninth Circuit's decisions. Petitioner cites as conflicting numerous cases which hold that a buyer in the ordinary course of business takes free of liens recorded pursuant to the Federal Aviation Act. Far from conflicting from the holding by the Ninth Circuit in the instant case, the holdings in these cases are based on reasoning similar to the reasoning of the Ninth Circuit; i.e., that the Federal Aviation Act provides for a uniform system of recordation but does not govern priority disputes between federally recorded instruments as against competing rights declared by state law.

As the following Argument will demonstrate, the cases cited as establishing conflicting decisions do not in fact conflict with the Ninth Circuit's decision. The Ninth Circuit, like other courts, has sensibly and correctly construed the federal statute involved in a manner which accounts for the interest of the federal government in air travel and the interest of the states in day-to-day commercial activity.

ARGUMENT

I.

THE NINTH CIRCUIT HELD THAT AN ENTITY WHICH PERFORMS SERVICES ON AN AIRCRAFT AND OBTAINS A LIEN FOR THE VALUE OF ITS SERVICES MAY PERFECT ITS LIEN BY POSSESSION OF THE COLLATERAL AS WELL AS BY RECORDATION OF THE LIEN PURSUANT TO THE PROVISIONS OF THE FEDERAL AVIATION ACT.

The Ninth Circuit in the instant case decided that under California law World obtained both a statutory and a consensual lien. *In re Holiday Airlines Corp.*, 647 F.2d 977, 981 (9th Cir. 1981) (hereinafter cited to Appendix pagination). Petitioner has not presented this part of the Court's decision as a "Question Presented" in his Petition For A Writ Of Certiorari.

The Court held that World's lien was, under California law, perfected by possession of the collateral (the airplane). *Id.* at A-6-8. The Ninth Circuit inquired whether World had "an interest under California law that is superior to any lien that is 'obtainable by legal or equitable proceedings' on a simple contract. Section 60(a)(2) Bankruptcy Act, 11 U.S.C. § 96 (1976)." *Id.* at A-6. The Ninth Circuit concluded that World's "perfected security interest is not subordinate to a subsequent lien creditor. *See* Cal. Comm. Code § 9301-(1)(b)." *Id.* at A-8.

The first "Question Presented" of Petitioner implies, and Petitioner's "Reasons For Granting The Writ" expressly maintains, that the Ninth Circuit considered the rights of a lien holder versus the rights of a bona fide purchaser. *Petition* at i and 9. The Ninth Circuit simply did not address this issue. Rather, as the above quotes indicate, the Court considered the rights of a lien holder versus the rights of a Trustee in Bankruptcy, who as to personal property has the rights of a judicial lien creditor. Therefore, cases which discussed the

rights of a bona fide purchaser are not relevant to the Ninth Circuit's decision except to the extent that the reasoning which is used to limit the preemptive effect of the recordation provisions of the Federal Aviation Act as to bona fide purchasers is by analogy supportive of the Ninth Circuit's reasoning used to limit the preemptive effect of the recordation provisions of the Federal Aviation Act as to perfection by possession.

The Ninth Circuit did address the question of the effect of World's failure to record its lien. *Holiday* at A-4-6. Petitioner maintains that the Ninth Circuit held "that Congress has not premepted [sic] the field of recordation of interests in aircraft." *Petition* at 9. The Ninth Circuit issued no such decision.

The Ninth Circuit carefully considered the extent to which § 1403 preempts local law. *Holiday* at A-4-6. In fact, the Ninth Circuit expressly noted that perfection of nonpossessory consensual liens will require recording under the provisions of the Federal Aviation Act. *Id.* at A-6. *The Ninth Circuit issued the narrow holding that an entity which performs services on an aircraft and obtains a lien on an aircraft may perfect its lien by possession as well as by recordation under federal law. Id.* at A-6. The Ninth Circuit noted that similar views had been expressed in *Colonial Trust Co. v. Goggin*, 230 F.2d 634 (9th Cir. 1955); and in *State Securities Co. v. Aviation Enterprises, Inc.*, 355 F.2d 225 (10th Cir. 1966). The Ninth Circuit also noted that decisions such as *Sanders v. M. D. Aircraft Sales Inc.*, 575 F.2d 1086 (3rd Cir. 1978) and *Haynes v. General Electric Credit Corp.* 582 F.2d 869 (4th Cir. 1978) upholding the rights of bona fide purchasers employed "the same approach" as to the preemptive effect of the Federal Aviation Act. *Holiday* at A-5.

Once the holding of the Ninth Circuit is correctly stated, the cases cited by Petitioner as establishing a conflict are seen to be irrelevant to, distinguishable from, or strongly supportive of the Ninth Circuit's decision. The balance of this Argument will

simply discuss the cases cited by Petitioner and demonstrate that they do not conflict with the decision of the Ninth Circuit. The Argument ends with a brief discussion of Petitioner's contention that the decision of the Ninth Circuit, if left standing, "will cause chaos in the aircraft financing industry and will render meaningless the recordation provisions of the Federal Aviation Act." *Petition* at 10.

II.

THERE IS NO CONFLICT AMONG THE FEDERAL COURTS OF APPEALS.

Petitioner cites several cases to establish that there is a conflict between the Ninth Circuit and other Federal Courts of Appeals. However, an examination of these cases shows that no such conflict exists. To the contrary, the decisons of the other circuits strongly support the instant decision of the Ninth Circuit.

Petitioner cites the Tenth Circuit's decision in *State Securities Co. v. Aviation Enterprises, Inc.*, 355 F.2d 225 (10th Cir. 1966) for the proposition that "[t]he area that *is* preempted by 49 U.S.C. § 1403 is the manner in which consensual liens are to be perfected." [Emphasis in original.] *Petition* at 12. Petitioner excerpts the following quote to support this proposition:

> "By providing a federal system for registration of conveyances and liens effecting the title to aircraft, Congress has preempted that field and state recording statutes are not applicable to such title instruments. However, questions of validity of such documents, actual notice, good faith purchaser status, and the like, must be resolved under state law." *Petition* at 12; *State* at 229.

As the above quote shows, the Tenth Circuit in *State* concluded that the Federal Aviation Act preempts *state law recording statutes*. The Tenth Circuit expressly states that

questions of validity of documents, notice, good faith purchaser status, and the like, are still resolved under the applicable state law. Not surprisingly, the Ninth Circuit in the instant case cited *State* as a case which supported the Ninth Circuit's reasoning that § 1403 does not preempt state law to the full extent that an initial, cursory reading of § 1403 might first suggest. *Holiday* at A-5.

Petitioner ducks the issue of the relationship of § 1403 and § 1406, and thereby distorts cases dealing with the preemptive effect of § 1403. Section 1403 requires that recordation be performed at a federal office. Section 1406 provides that the validity of an instrument to be recorded shall be governed by state law. These two statutes leave gaps: for instance, if a valid lien interest (state law determination) is properly recorded (federal law determination) what law determines the effect of a sale of the collateral to a bona fide purchaser on the lien holder's interest in the collateral. As the quote from *State* shows, the Tenth Circuit applies state law to determine the status and rights of a bona fide purchaser. Similarly, the Ninth Circuit in the instant case looked to state law to determine the status and rights of a person who performs services, maintains possession of collateral, and obtains a statutory or consensual lien.

Petitioner maintains that the Fifth Circuit in *Bank of Lexington v. Jack Adams Aircraft Sales, Inc.*, 570 F.2d 1220 (5th Cir. 1978) reached the conclusion that § 1403 preempts the "manner in which consensual liens on aircraft are to be perfected." *Petition* at 12, 13. Petitioner excerpts the following quote to support his analysis:

> "The Federal Aviation Act created a framework for a nationwide system to record certain interests in aircraft and major aircraft components . . . to the extent that state law conflicts with any part of the Act, it is preempted under the power of Congress to regulate interstate commerce . . .

> *there is no question that Congress has preempted the field insofar as registration and recording of title instruments affecting commercial aircraft is concerned.*" (Emphasis added by Petitioner). *Petitioner* at 13; *Lexington* at 1224.

As the above quote shows, the Fifth Circuit maintains that § 1403 only preempts the field of registration and recording, a principal with which the Ninth Ciruit agrees. In *Lexington*, the Fifth Circuit used state law to determine the legal effect of an assignment of a security interest. The Fifth Circuit stated that "the Act preempts only that portion of state law which conflicts with its provisions . . . because no provision of the Federal Aviation Act addresses our question of the viability of the assignment of a security interest, state law will provide our rule of decision." *Id.* at 1225.

Petitioner admits that *Colonial Trust v. Goggin*, 230 F.2d 634 (9th Cir. 1955) remains "good law." *Petition* at 12. Yet, in *Colonial*, the Ninth Circuit noted that:

> "[W]here an article of personal property of whatever character is in possession of one who has expended work and labor thereon at the request of a person lawfully in possession, *the domestic law of the place of possession governs as to the extent and character of the lien.*" [Emphasis added.] *Id.* at 637.

Petitioner cites the decision in the District Court case of *Haynes v. General Electric Credit Corp.*, 432 F. Supp. 763 (W.D. Va. 1977) as conflicting with the Ninth Circuit's decision in the instant case. *Petition* at 9. To the contrary, the District Court held that the recordation provisions of the Federal Aviation Act did not preempt state law which would otherwise govern the status and rights of bona fide purchasers. *Id.* at 765. The Court held that "Congress did not intend by adoption of the cited recordation provision [Section 1403] to displace state law that would otherwise govern priority disputes of lien and title interest in aircraft." *Id.* at 765. The Court also held that:

> "[F]ederal law governs the relative rights of third parties and other claimants to the aircraft *only to the extent that these rights are dependent on the fact or time of recordation.* Questions such as the validity of title documents, good faith purchaser status and the like, must be resolved under state law." [Emphasis added.] *Id.* at 767.

In *Haynes v. General Electric Credit Corp.*, 582 F.2d 869 (4th Cir. 1978), the Fourth Circuit affirmed the decision of the District Court. The Fourth Circuit expressly stated that it affirmed the holding that:

> "Section 1403, which provides for a system of recordation of conveyances affecting title to or security interests in civil aircraft of the United States, does not preempt the rule of the Uniform Commercial Code that a 'buyer in the ordinary course of business' takes chattels free of a security interest created by his seller. *Congress did not intend . . . to create affirmative priority of federally recorded interest as against competing rights declared by state law.* [Emphasis added.] *Id.* at 870.

Similarly, the Third Circuit in *Sanders v. M.D. Aircraft Sales Inc.*, 575 F.2d 1086 (3rd Cir. 1978) held that a bona fide purchaser takes free of federally recorded liens. The Third Circuit rejected the argument that the predecessor statute to § 1403 "displaced state law." *Id.* at 1088.

As *Colonial* demonstrates, the Ninth Circuit's position for over 25 years has been that the recordation provisions of the Federal Aviation Act do not totally preempt state law. As *Sanders, Haynes,* and *Lexington* demonstrate, this construction of the recordation provisions is consistent with the construction given the recordation provisions by the Third, Fourth, and Fifth Circuit Courts of Appeals. Petitioner has cited these cases as establishing a conflict amongst Federal Courts of Appeals, but there is in fact no conflict.

III.

THERE IS NO CONFLICT BETWEEN THE NINTH CIRCUIT AND THE DISTRICT COURTS.

Rule 17 of the Supreme Court Rules does not mention a conflict between a Federal Court of Appeals and a Federal District Court as a situation in which the Supreme Court will issue a writ of certiorari. Because such a conflict may play a minimal role in this Court's decision-making process, Respondent will proceed in this Argument to demonstrate that the District Court cases cited by Petitioner do not establish a conflict.

In *Industrial National Bank of R.I. v. Butler Aviation International, Inc.*, 370 F.Supp. 1012 (E.D.N.Y. 1974), a New York District Court held that a bailee's possessory lien on an aircraft for storage charges was superior to a federally recorded lien on the aircraft. *Id.* at 1017. The Court held that Congress had not "decreed total federal preemption in this area." *Id.* at 1017. The Court noted that decisions which speak of federal preemption, when carefully read, are actually "far more concerned with resolving the question of whether Congress has the *power* to totally preempt the field of aircraft title and lien recordation [rather] than the extent to which Congress has in fact exercised the power by the statute in question." [Emphasis in original.] *Id.* at 1017. Amazingly, Petitioner cites this case as conflicting with the instant case. *Petition* at 9. Similarly, in *Northern Illinois Corp. v. Bishop Distributing Co.*, 284 F.Supp. 121 (W.D. Mich. 1968), a Michigan District Court held that § 1403 did not preempt state law which provided that a buyer in the ordinary course of business defeated the rights of a recorded-lien holder.

The North Carolina District Court's decision in *Marsden v. Southern Flight Service, Inc.*, 227 F.Supp. 411 (M.D.N.C. 1961), so heavily relied on by Petitioner, is distinguishable from the instant case. In that case, a purchaser of an aircraft

sought to defeat the rights of a recorded chattel mortgagee of the aircraft. *Id.* at 412-15. The purchaser was not concerned with the preemptive effect of the federal recordation provisions over otherwise applicable state law. Rather, the purchaser argued that the "actual notice" exception to the Federal Aviation Act's recordation provisions was satisfied by the purchaser's possession of the aircraft. *Id.* at 415-16. The District Court did not accept this construction of the "actual notice" exception. *Id.* at 416. The District Court did not consider the preemptive effect of the recordation provisions on competing rights created by state law.

Feldman v. Chase Manhattan Bank, N.A., 368 F.Supp. 1327 (S.D.N.Y. 1974), also heavily relied on by Petitioner, is likewise distinguishable from the instant case. In that case, a bank recorded its chattel mortgage interest but not the bank's lease and assignment of rents interests. In holding the latter interests invalid, the District Court relied on the fact that persons concerned with the status of the aircraft would be misled by the incomplete filings and conclude that the debtor retained a possessory interest in the aircraft. *Id.* at 1332.

The District Court decided that "Section 1403 should be broadly construed . . . when the failure to record might be misleading to creditors." *Id.* at 1332.

In the instant case, World has not misled creditors by filing documents which do not fully reflect World's interest. It is worth noting that in the companion case to *Feldman v. Chase*, the New York District Court in *Feldman v. First National City Bank*, 368 F.Supp. 1333 (S.D.N.Y. 1974) applied state law to decide the issue of the period of limitations applicable to § 1403 litigation. *Id.* at 1339. The District Court noted that:

> "The preemption of otherwise applicable state law by § 1403 of the Federal Aviation Act . . . is considerably less than total. It has been established that such preemption

> goes only to the validity of purported security interests and does not determine the issue of priority of security interests . . . nor validate security interests which are void under federal law." *Id.* at 1338.

Not only is *Feldman v. Chase* distinguishable from the instant case, the significance of that decision is even further eroded by the decision of the Second Circuit in *Feldman v. Chase Manhattan Bank N.A.*, 511 F.2d 468, 470 (2nd Cir. 1975). In that decision, the Second Circuit reversed the District Court, holding that in the circumstances presented in that case, the Trustee was equitably estopped from asserting claims based on the federal statute. The Second Circuit ignored the substantive analysis of the District Court and simply stated that:

> "whatever may be the merits of the Trustee's argument that this interest was unperfected, we find convincing reasons for holding that [the Trustee] should be barred from challenging it by reason of equitable estoppel considerations."

That Petitioner relies on the two District Court cases of *Marsden* and *Feldman* demonstrates the weakness of his position. As has been shown, the Circuit Courts of Appeal agree with the Ninth Circuit, as do most of the District Court cases cited by Petitioner. *Marsden* and *Feldman* are distinguishable. The remaining District Court cases cited by Petitioner as conflicting actually support the decision of the Ninth Circuit. *Texas National Bank of Houston v. Aufderheide*, 235 F.Supp. 599 (E.D. Ark. 1964) held that a buyer in the ordinary course of business takes free of a federally recorded lien. *United States Aviation Underwriters, Inc. v. WTAE Flying Club*, 300 F.Supp. 341, 348 (W.D. Pa. 1969) held that a bona fide purchaser of goods takes free of liens of third parties in the goods, "notwithstanding that [such] lien was perfected by filing with the Federal Aviation Agency."

In *In re Veterans' Air Express Co.*, 76 F.Supp. 684 (D.N.J. 1948), the Court analyzed the power of Congress to regulate interstate commerce. The Court concerned itself with the rights

of the federal government as a lien holder and concluded that "Federal statutes may declare liens in favor of the government and establish their priority over subsequent purchaser or lienors irrespective of state recording acts." *Id.* at 690. *United States v. United Aircraft Corp.*, 80 F.Supp. 52, 54 (D.Conn. 1948) held that a federally recorded instrument did not create a valid lien due to the instrument's insufficient description.

IV.

THE NINTH CIRCUIT'S DECISION FULFILLS THE INTENT OF CONGRESS.

Petitioner maintains that the Ninth Circuit's decision would destroy "all certainty in the aircraft financing industry." *Petition* at 16. While this argument addresses the merits of the Ninth Circuit's decision and not the issue of conflict of decisions among the Circuits, a brief response to Petitioner's contention is warranted.

The Ninth Circuit's decision does not defeat the purpose of the Federal Aviation Act to create a central agency for the recordation of documents affecting title to aircraft. As recognized by the District Court in *Industrial National Bank*, Congress, aware of the mobility of aircraft, intended to lift the burdensome requirement of title searches in numerous states. *Id.* at 1016. However, Congress did not intend:

> "[t]o subject state-created liens of the type here involved to federal recording requirements . . . Indeed it seems inconceivable that Congress could have intended to impede the ability of proprietors of essential aviation facilities to collect their legitimate charges for servicing aircraft, when the overall congressional purpose was to promote the development and safety of civil aviation." *Id.* at 1017.

It is impossible to reconcile Petitioner's dire warnings about the Ninth Circuit's decision in the instant case with

Petitioner's approving citation to cases such as *Haynes*, *Industrial National Bank*, and *Texas National Bank*. In those cases, unrecorded interests (the interests of bona fide purchasers) defeated the interest of federally recorded documents. In those cases, as in the instant case, state-created rights were held not to be preempted by the recordation provisions of the Federal Aviation Act.

The decision of the Ninth Circuit in the instant case does not conflict with the decision of other Courts, nor does it frustrate the intent of Congress.

CONCLUSION

For each of the foregoing reasons, Respondent respectfully submits that the Petition For Writ Of Certiorari be denied.

Respectfully submitted,

SULMEYER, KUPETZ, BAUMANN & ROTHMAN
a professional corporation

By IRVING SULMEYER
Irving Sulmeyer
Attorneys for Respondent

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In the Matter of:

HOLIDAY AIRLINES CORPORATION, a California corporation (formerly known as Holiday Recreational Resources and Holiday Resources Corporation),

Bankrupt.

CURTIS B. DANNING, Trustee in Bankruptcy of HOLIDAY AIRLINES CORPORATION, a California corporation (formerly known as Holiday Recreational Resources and Holiday Resources Corporation),

Plaintiff-Appellee,

vs.

WORLD AIRWAYS, INC.,

Defendant-Appellant.

No. 79-3148

Argued and Submitted Dec. 3, 1980
Decided June 8, 1981

Appeal from the United States District Court for the Central District of California.

Before GIBSON*, SNEED and POOLE, Circuit Judges.

SNEED, Circuit Judge:

This is a bankruptcy case in which the issue is whether World Airways, Inc., a creditor of the bankrupt Holiday Airlines Corporation, Inc., received a preference recoverable by

*Honorable Floyd R. Gibson, Senior United States Circuit Judge for the Eighth Circuit, sitting by designation.

Holiday's Trustee in bankruptcy when it received payment for services and maintenance on a Lockheed-Electra aircraft, No. N-971-HA (971), which was under lease to Holiday, from the proceeds derived from the sale of another aircraft, No. N-974-HA (974), which was owned by Holiday. If the receipt by World of this payment were merely the proceeds from the liquidation of its previously perfected security interest, which itself was immune from an attack by Holiday's Trustee, it would not be a preference. On the other hand, if it were a payment from proceeds, to which it had no claim better than that of a general creditor, to discharge the antecedent debt that arose from its services and maintenance with respect to aircraft 971, it would be a preference. We hold that the former is the proper characterization and that the payment was not a preference. Therefore, we reverse the judgment of the district court and remand this case to that court for further proceedings consistent with this holding and the opinion that follows.

I

FACTS

Aircraft 971 was leased to Holiday by Petroleum Investment Services, Inc. and was subject to a security interest in favor of the Central Bank and Trust Company of Denver, Colorado. The agreement between Petroleum and Holiday provides that Holiday was required at its own expense to maintain the aircraft in good order and repair and to perform such maintenance and inspection as necessary to comply with FAA Air Worthiness directives. Petroleum assigned Holiday's rental payments to the Denver bank presumably to be applied against the debt secured by the bank's security interest in aircraft 971.

On October 7, 1973 Holiday entered into what was designated a Maintenance, Overhaul and Repair Agreement with World for the purpose of servicing Holiday's aircraft. The Agreement contained the following provision:

> "[World] shall have a lien upon customer's aircraft and components for the value of all services furnished, including, without limitation, reasonable compensation for storage incurred by [World] by reason of customer's failure to accept delivery of aircraft or other flight equipment." Endorsement No. 2, paragraph (7).

On December 7, 1974, Holiday delivered aircraft 971 to World for servicing and maintenance and World supplied services and maintenance which had a reasonable value of $70,165.05. Aircraft 971 remained continuously in World's possession from the date of its delivery to January 24, 1975. World did not give written notice to Petroleum or the Denver bank prior to supplying these services, nor was written consent of either sought or obtained in connection with these services. World never attempted to record its lien on aircraft 971 with the Federal Aviation Administration pursuant to 49 U.S.C. § 1403.

On January 24, 1975 all of Holiday's aircraft, including both 971 and 974, were in World's possession for servicing. To meet its schedule commitments Holiday needed to obtain the release of at least some of its aircraft but World would release none unless payment for services was made or adequate security to assure such payment was made. To solve this problem it was agreed that World would surrender possession of aircraft 971 and Holiday would execute and deliver to World a chattel mortgage on aircraft 974 to secure the $70,165.05 owed with respect to aircraft 971. This was accomplished in January 24, 1975. However, possession of aircraft 971 was surrendered several hours before the chattel mortgage on aircraft 974 was executed and delivered. This chattel mortgage was recorded pursuant to 49 U.S.C. § 1403 on January 28, 1975.

Aircraft 974 was sold immediately thereafter and World received payment on January 31, 1975 of the $70,165.05 due for servicing aircraft 971. The end for the purposes of this case came shortly thereafter. On February 13, 1975 Holiday filed under Chap. XI and subsequently was adjudicated bankrupt.

To support his contention that the payment to World of $70,165.05 was a preference the Trustee contends that World had no valid perfected lien on aircraft 971 with the consequence that the chattel mortgage on aircraft 974 and the resulting payment were in discharge of an antecedent debt. World disputes this vigorously. It argues that a valid perfected lien on aircraft 971 existed from the time it serviced the aircraft. The lien's validity, World asserts, rests on either Cal.Civ.Pro.Code § 1208.61 and § 1208.62 or Cal.Com.Code § 9305. The Trustee responds by contending (1) that a failure to record World's lien pursuant to 49 U.S.C. § 1403 left it unperfected, (2) that in any event World's lien was invalid, except to the extent of $250, under Cal.Civ.Pro.Code § 1208.62, because no notice was given to either Petroleum or the Denver bank prior to commencing to service aircraft 971 and no written consent to do the work was obtained from either, (3) that no consensual lien perfected by possession pursuant to Cal.Com.Code § 9305 exists, and (4) that should one exist it was surrendered prior to the execution of the chattel mortgage on aircraft 974 and the payment of $70,165.05 by Holiday.

Inasmuch as we hold that a valid consensual lien perfected by possession did exist and that the gap of a few hours between the surrender of possession of aircraft 971 and the execution of the chattel mortgage on aircraft 974 is without legal significance for the purpose of this case, there exists no reason for us to address the questions raised by the trustee concerning a lien asserted pursuant to Cal.Civ.Pro.Code §1208.62. We also hold that World's consensual lien perfected by possession is not invalid for failure to be recorded pursuant to 49 U.S.C. § 1403.

II

THE EFFECT OF FAILURE TO RECORD PURSUANT TO 49 U.S.C. § 1403

The Trustee is correct when he contends that a preference exists if recordation by World under 49 U.S.C. § 1403 is necessary to perfect its lien on aircraft 971. Section 1403(c)

provides some support for the position that such recordation is necessary. It states that "no conveyance or instrument," able to be recorded under the act, "shall be valid in respect of such aircraft . . . against any person," other than the parties to the conveyance or instrument," until such conveyance or other instrument is filed . . ."

Section 1403 does not preempt local law to the full extent that this extract might suggest. The court observed in *Colonial Trust Co. v. Goggin*, 230 F.2d 634, 637 (9th Cir. 1955), that, notwithstanding the federal recordation system, "where an article of personal property of whatever character is in possession of one who has expended work and labor thereon at the request of the person lawfully in possession, the domestic law of the place of possession governs as to the extent and character of the lien." A similar view has been expressed in *State Securities Company v. Aviation Enterprises, Inc.*, 355 F.2d 225, 229 (10th Cir. 1966). Several decisions upholding the rights of a purchaser in the ordinary course of business under state law as against holders of floor plan financing liens recorded under federal law employ the same approach. *See Sanders v. Aircraft Sales Inc.*, 575 F.2d 1086 (3d Cir. 1978); *Haynes v. General Electric Credit Corporation*, 582 F.2d 869 (4th Cir. 1978). Both *Sanders* and *Haynes* declined to read section 1406 so as to preempt provisions of the relevant state's version of the Uniform Commercial Code which were designed to protect purchasers in the ordinary course of business. The Supreme Court of California has reached the opposite conclusion. *See Dowell v. Beech Acceptance Corp., Inc.*, 3 Cal.3d 544, 91 Cal.Rptr. 1, 476 P.2d 401 (1970). The financing agency prevailed over the buyer in the ordinary course of business because of the preemptive effect accorded section 1406 by the California court.

Despite the reference of 49 U.S.C. § 1406 to state law as determining the validity of liens recorded under section 1403, we are not bound by state court decisions on the preemptive effect of federal law.[1] *Shell Oil Co. v. Younger*, 587 F.2d 34,

[1] We, of course, express no opinion on the effect of state decisions on preemption in diversity cases.

36-37 (9th Cir. 1978)(California Supreme Court decision interpreting the preemptive scope of the Sherman Act not controlling in a case construing a similar state statute and its preemption by the Sherman Act); *Clifton v. Cox*, 549 F.2d 722, 730 (9th Cir. 1977)(state courts have no power to bind the federal courts with their rulings concerning the extent of federal power); *see Flournoy v. Wiener*, 321 U.S. 253, 270-72, 64 S.Ct. 548, 556-57, 88 L.Ed. 708 (1944)(Frankfurter, J., dissenting)(construction of federal law necessary to decision under state law gives rise to a federal question); *Standard Oil of California v. Johnson*, 316 U.S. 481, 62 S.Ct. 1168, 86 L.Ed. 1611 (1942); *Smith v. Kansas City Title & Trust Co.*, 255 U.S. 180, 41 S.Ct. 243, 65 L.Ed. 577 (1921). We hold that the failure of World to record its consensual lien on aircraft 971 while in its possession under the circumstances of this case does not make perfection of its lien impossible as a matter of federal law. This holding is limited to consensual liens perfected by possession. It does not embrace consensual liens when the lienholder is not in possession. Perfection of such liens will require recording under 49 U.S.C. § 1406.

III

WORLD'S CONSENSUAL LIEN PERFECTED BY POSSESSION

The question remaining is whether, absent any preemptive effect of sections 1403 and 1406, a consensual lienholder who has not recorded his lien and is in possession of an airplane has an interest under California law that is superior to any lien that is "obtainable by legal or equitable proceedings" on a simple contract. Section 60(a)(2) Bankruptcy Act, 11 U.S.C. § 96 (1976). A demonstration is now necessary that, under California law, World held a consensual lien on aircraft 971 perfected by possession. The Maintenance, Overhaul and Repair Agreement set out above clearly indicates that a lien for services, repairs, and any storage was intended. Both the bankruptcy judge and the district court treated this provision as but a

reference to the statutory lien provided by Cal.Civ.Pro.Code § 1208.61 and § 1208.62. Therefore, both were compelled to determine whether World's statutory lien had been perfected beyond the minimal amount of $250. As to this they differed, the bankruptcy judge holding that it had and the district court that it had not.

We hold that it was clearly erroneous to disregard the plain language of the Agreement between Holiday and World and to treat the lien provision as surplusage in effect. Without tarrying to determine whether this treatment of the lien provision by both the bankruptcy judge and the district court was a finding of fact, a conclusion of law, or a mixed question of law and fact, we have a sufficiently firm conviction that it is wrong to require that we proceed differently. The more natural and normal reading of the lien provisions in the Agreement is that World was to have a lien for its services to the full extent that an explicit agreement to that effect would permit under California law. This would embrace *both* the statutory and a consensual lien. Expressed colloquially, we read the Agreement as providing World a lien for its services by any, and all, means available under California law.

The framework within which a consensual lien, such as World asserts, functions under California law is provided by Article 9 of California's version of the Uniform Commercial Code. Section 9102(1)(a), Cal.Comm.Code, provides that "Division 9" applies "To any transaction (regardless of form) which is intended to create a security interest in personal property, including goods . . ." The term "goods" is defined to include "all things which are movable at the time the security interest attaches. . . .," Cal.Comm.Code, § 9105(1)(f), which clearly embraces aircraft 971. More specifically, the aircraft fell within the definition of "equipment" set forth in Cal.Comm.Code § 9109 because it was goods "used or bought for use primarily in business. . ." perfection of a "security interest" in "goods," under Cal.Comm.Code § 9305, may be achieved by "the secured party's taking possession of the

collateral." This is, of course, precisely what World did with respect to aircraft 971. This perfection commences when "possession is taken without relation back and continues only so long as possession is retained. . ." *Ibid.* A perfected security interest is not subordinate to a subsequent lien creditor. *See* Cal.Comm.Code § 9301(1)(b).

Without question World is entitled to its agreed upon "security interest" which it perfected by taking possession of the "goods." Nor does the existence of the statutory lien for repairs on aircraft provided by Cal.Civ.Pro. Code § 120.61 and § 1208.62 preclude the operation of "Division 9" of the commercial Code. While it is true that "Division 9" does not preempt section 1208.61 and 1208.62 liens, *see* Cal.Comm.Code § 9104(c), it is also true that there exists no indication these statutory liens are intended to preclude the application to aircraft of those provisions of "Division 9" not in conflict thereto.

Thus, we hold that World possessed a consensual lien to secure its services and maintenance with respect to aircraft 971 perfected by possession and recognized by California law.[2]

It has not been suggested by the parties that this holding would impinge in any way upon the interests of either Petroleum Investment Services, Inc. or Central Bank and Trust Co. Had such a suggestion been made it might have been necessary to consider the effect of Holiday's undertaking in its agreement with Petroleum to maintain the aircraft in good order and repair. However, under the circumstances of this case no such examination is necessary.

IV

THE "GAP" PROBLEM

Inasmuch as World's lien on aircraft 971 lost its perfected status on January 24, 1975 when possession of this aircraft was surrendered to Holiday several hours before the chattel mortgage on aircraft 974 was executed, it is possible to argue that

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[2] We decline to believe that the California Supreme Court would interpret its holding in *Dowell v. Beech Acceptance Corp., supra*, as decision based on state law so as to reverse this result.

execution of the mortgage and payment of $70,165.05 to World was in discharge of an antecedent debt and did cause a diminution of Holiday's estate. It would be pointed out that, rather than a mere *substitution* of security occurring, the proper characterization is that the chattel mortgage *replaced* perfected security previously surrendered.

The *replacement* characterization exalts form over substance. A similar analysis, also employed to claim that the creation of a security interest amounted to a preference, has been rejected when, to secure a current advance, the instrument creating the previously agreed upon security interest was executed several days after the date of the advance. *Dean v. Davis*, 242 U.S. 438, 37 S.Ct. 130, 61 L.Ed. 419 (1917). Substantial contemporaneity appears to be all that is required. *Id* at 443, 37 S.Ct. at 131. The proper characterization, therefore, is that the events of January 24, 1975 constituted a *substitution* of one security for another. This did not amount to a preference where no diminution of the debtor's estate occurred. *See* 4 Collier on Bankruptcy, § 547.22 (1980). None such occurred here.[3] We hold that the so-called "gap" on January 24, 1975 generated no preference.

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[3] The determination of whether such an exchange constitutes a preference turns on whether it results in a diminution of the bankrupt's estate, not on whether or not the creditor's security was enhanced. 4 Collier on Bankruptcy ¶ 547.22 (1980). Prior to the exchange, Holiday's estate contained (1) its ownership interest in aircraft 974 and (2) its leasehold interest in aircraft 971 encumbered by a lien for $70,165.05. After the exchange, Holiday's estate contained (a) its ownership interest in aircraft 974 encumbered by a chattel mortgage for $70,165.05 and (b) its leasehold interest in aircraft 971. If the sum of the latter two values is greater than or equal to the sum of the two former values, there was no preference. Put another way, if value (b) was less than $70,165.05, there was a preference. *See In re Star Spring Bed Co.*, 265 F. 133 (3d Cir. 1920). No finding appears to have been made below concerning the value of Holiday's leasehold in aircraft 971. However, because of the bankruptcy court's finding that there was no preference and the failure of either the parties or the district court to raise the issue of the value of Holiday's leasehold, we assume that its value was greater than $70,165.05.

National City Bank v. Hotchkiss, 231 U.S. 50, 34 S.Ct. 20, 58 L.Ed 115 (1913), does not require a different holding. There the Court found a preference when creation of the security interest followed the advance because at the time of the advance no security was considered necessary. The rapid deterioration of the debtor activated the desire to obtain security. Nothing of this sort occurred here. A substitution of security was contemplated from the beginning. *Dean v. Davis, supra*, not *National City Bank v. Hotchkiss, supra*, governs this case.

Finally, we note that, because World's chattel mortgage was recorded pursuant to 49 U.S.C. § 1403, the payment to World of $70,165.05 was not be discharge an unperfected lien and was, hence, not a preference.

Reversed and Remanded.

GIBSON, Senior Circuit Judge, concurring.

I concur in Judge Sneed's opinion. My rationale for finding a valid consensual lien is that Holiday had sufficient "rights in the collateral," Cal.Comm.Code § 9204, to enter into a security agreement with World Airways for the limited purpose of obtaining services and maintenance on the aircraft. While a leasehold may not be a sufficient interest upon which to ordinarily allow the lessee to base a security interest, as outlined in Judge Poole's dissenting opinion, the lease agreement between Petroleum and Holiday did provide that Holiday was required at its own expense to maintain the aircraft. Holiday remained liable for the cost of repairs. The lessee had an implied right, therefore, to place the aircraft in the possession of a third party for the purpose of obtaining reasonable repairs which could give rise to a mechanic's lien. Rarely are repairs, particularly of this magnitude, paid for in advance. Maintenance of the plane in good working order, furthermore, is obviously beneficial to both the lessor and the lessee. Third party creditors' rights and security interests might also be impaired if the aircraft were allowed to fall into a state of disrepair.

POOLE, Circuit Judge, dissenting.

I respectfully dissent. In my view, under the provisions of California law relied upon by the majority, Holiday Airlines, Inc. (Holiday) lacked the power to consent to the creation of a security interest in an aircraft which it did not own. Therefore, the consensual lien which Holiday attempted to grant to World Airways, Inc. (World) never attached to aircraft 971; World perfected by possession only that which it was granted, to wit, an unattached, ineffective lien. As World had no valid, perfected lien in 971, the security interest which it acquired through substitution in aircraft 974 was preferential within the meaning of § 60 of the Bankruptcy Act, 11 U.S.C. § 96 (1976), and the judgment of the district court should be affirmed.

In part III the majority concludes that the repair agreement between Holiday, lessee of 971, and World, the repairman, created a consensual lien under California law which World perfected when it took 971 into its possession. *See* Cal.Comm.Code §§ 9204, 9305; Maj. op., at 981. This provision of the repair contract, set out at page 978 of the majority opinion, is not the only part of the record before us relevant to determining the validity of World's alleged consensual lien. Holiday was the lessee of 971. Its possessory rights stemmed from a lease agreement with Petroleum Investment Services, Inc. (Petroleum), the owner, which provides that Holiday had no power to permit any lien or encumbrance to arise on 971.[1] Holiday's status as a lessee and this explicit prohibition on encumbrance of 971 undermine the majority theory that under California law a consensual lien arose by virtue of the repair agreement.

In order to establish a consensual lien against one who is not a party to the agreement creating the disputed security interest, the interest must attach to the collateral and be

[1] The lease between Petroleum and Holiday reads:
THIRTEENTH—LESSEE shall have no right to consent to, allow, or permit any liens or encumbrances on said AIRCRAFT.

perfected. There is no doubt that whatever interest World obtained became perfected under California law when it took possession of 971. Cal.Comm.Code § 9305. However, World could perfect only that interest which had attached to 971 and which Holiday had the power to cause to attach. If Holiday lacked the power to impress a lien on 971, then no interest ever attached in the aircraft and World could have perfected by possession only an ineffective, unattached interest. This is our case.

Mere recitation of the security interest in the repair contract is insufficient to establish that the interest attached to 971. *See Chartered Bank of London v. Chrysler Corp.*, 115 Cal. App.3d 755, 760, 171 Cal.Rptr. 748, 750 (1981). Rather in order for a security interest to attach in a chattel, there must be "an agreement . . . that it attach and value is given and the debtor has rights in the collateral." Cal.Comm.Code § 9204. The majority's analysis of § 9204 is faulty because World cannot demonstrate on this record that Holiday possessed sufficient "rights in the collateral," 971, to encumber it by consensual agreement. *See Chartered Bank, supra* (party asserting validity of a security interest will be required to show that debtor had "rights in the collateral" sufficient to create the interest).

Certainly an owner may encumber his property and subject it to a consensual security interest. Holiday, however, is not an owner, but a lessee. Under Article 9, a lessee may generally not encumber his lessor's property. *See, e.g., Disch v. Raven Transfer & Storage Co.*, 17 Wash.App. 73, 561 P.2d 1097 (1977).[2] The majority does not dispute, nor does it purport to

[2] *See generally* Anzivino, *When Does a Debtor Have Rights in the Collateral Under Article 9 of the Uniform Commercial Code*, 61 Marq. L.Rev. 23, 29-31 (1977).

alter this rule. Holiday's status as a lessee thus gives it no more than a lawful right to possession of 971, not the power to employ the aircraft as security.[3]

Notwithstanding its lessee status, Holiday could create a lien in 971 if Petroleum had authorized Holiday to enter into a consensual lien agreement. Under California law,

> [a] debtor who does not own collateral may nonetheless use the collateral for security, thereby obtaining rights in the collateral, when authorized to do so by the actual owner of the collateral.

K. N. C. Wholesale, Inc. v. AWMCO, Inc., 56 Cal.App.3d 315, 31819, 128 Cal.Rptr. 345, 348 (1976); *accord, Matter of Pubs, Inc. of Champaign*, 618 F.2d 432, 436 (7th Cir. 1980) (under Article 9, a lessee may have rights in collateral and encumber a lessor's chattel when lessor has expressly or implicitly authorized creation of the security interest).

On this record, it is impossible to find that Petroleum gave Holiday the power to encumber 971. The lease agreement expressly withdraws such power from Holiday. Petroleum never approved the repair agreement executed between Holiday and World nor has it taken any action which suggests its acquiescence in the creation of a lien by its lessee. When the right to pledge a chattel as security has been withheld by the owner, it is unreasonable to give effect to an attempt by a lessee to create such an interest.

The majority attempts to define away the difficulties presented to its analysis by the "rights in collateral" requirement of Cal.Comm.Code § 9204. At page 981, the opinion

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[3] It may be that a lessee has sufficient rights in a chattel to pledge it as collateral when the lease is designed to be a security interest or financing device rather than a traditional leasehold. *See* Anzivino, *supra*. There is no need to consider this possibility in this case because the parties clearly indicated that Holiday acquired no title or security interest in 971 by virtue of the lease. Similarly, nothing in any provision of the lease suggests that anything other than a traditional leasehold was created.

indicates that there is no suggestion in this case that the rights of Petroleum or the mortgagor of 971, Central Bank & Trust Co., are in any way impinged by the majority's holding and that if there were such a prospect a different case would be presented. This dubious observation overlooks that "[f]undamental to a secured party's acquisition of a security interest in property of the debtor is that the debtor have 'rights in the collateral.'" *Anthony v. Community Loan & Investment Corp.*, 559 F.2d 1363, 1368, *reh'g. denied*, 564 F.2d 416 (5th Cir. 1977).

Under Cal.Comm.Code § 9204, it is elementary that the existence of a valid security interest in 971 turns on whether Holiday had "rights in the collateral" which enabled it to pledge the aircraft. One cannot dispense with this requirement simply because the owner is not challenging the validity of the security interest a lessee attempted to create.

In his concurring opinion, Judge Gibson suggests that the necessary "rights in collateral" arise by virtue of the Petroleum-Holiday lease provision whereby Holiday must maintain 971 at its own expense and in accord with federal aviation standards. Judge Gibson would read this provision to mean "[t]he lessee had an implied right . . . to place the aircraft in the possession of a third party which could give rise to a mechanic's lien." Concurring Opinion. I cannot agree that the law of California permits us to imply this new covenant into the Petroleum-Holiday agreement.

Implied covenants are disfavored and the California Supreme Court has identified five factors which should be present before a covenant will be implied:

> (1) the implication must arise from the language used or it must be indispensable to effectuate the intention of the parties; (2) it must appear from the language used that it was so clearly within the contemplation of the parties that they deemed it unnecessary to express it; (3) implied covenants can only be justified on the grounds of legal necessity; (4) a promise can be implied only where it can

be rightfully assumed that it would have been made if attention had been called to it; (5) there can be no implied covenant where the subject is completely covered by the contract.

See, e.g., Stockton Dry Goods Co. v. Girsh, 36 Cal.2d 677, 681, 227 P.2d 1 (1951); Cal.Civ.Code § 1648.

Applying these standards, it is certainly not indispensable to a lessee's obligation to repair an airplane that the lessee have power to encumber the aircraft. The record here belies the prospect that the parties so clearly contemplated Holiday's power to encumber 971 for repairs that they thought it unnecessary to include such a provision in the lease. If it is legally necessary or sound policy to vindicate an aircraft repairman's lien, then it is for California's legislature to provide such protection, as has been done in Cal.Civ.Pro.Code §§ 1208.61, .62. The presence of this statutory aircraft repairman's lien makes it legally unnecessary to imply such a lien to a clear, consensual agreement. Finally, I doubt that we have the power under California law to imply a contract term which is contrary to the express terms of the parties' understanding. Petroleum and Holiday agree that Holiday was to have no power to consent to the creation of any liens in 971 and I am not willing to disregard this clear expression of their intention. I cannot embrace the "implied right" theory of the concurring opinion.

As the majority erroneously concludes that World acquired a valid consensual lien on 971 from Holiday under Cal.Comm. Code § 9204, I must conclude that the majority opinion provides an insufficient basis to reverse the judgment of the district court. I would affirm.[4]

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[4] As World never acquired a consensual lien that attached in 971 by virtue of the repair agreement, I find it unnecessary to consider, and express no view on, the preemptive effect of the Federal Aviation Act on consensual security interests created and perfected pursuant to provisions of the Uniform Commercial Code. Similarly, no useful purpose would be served by considering in this dissent other possible bases whereby World might have acquired a lien on 971. I dissent because the majority fails to provide an adequate legal basis to reverse the judgment of the district court.